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JAMES T. SHOTWELL, PH.D., LL.D.

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TAXATION DURING THE WAR

BY

SIR JOSIAH STAMP

G.B.E., LL.D., D.Sc., Sc.D., F.B.A.

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TO
N. F. W. F.
R. V. N. H.
G. B. C.
AND
E. C.

EDITOR'S PREFACE

IN the autumn of 1914, when the scientific study of the effects of war upon modern life passed suddenly from theory to history, the Division of Economics and History of the Carnegie Endowment for International Peace proposed to adjust the programme of its researches to the new and altered problems which the war presented. The existing programme, which had been prepared as the result of a conference of economists held at Berne in 1911, and which dealt with the facts then at hand, had just begun to show the quality of its contributions; but for many reasons it could no longer be followed out. A plan was therefore drawn up at the request of the Director of the Division, in which it was proposed, by means of an historical survey, to attempt to measure the economic cost of the war and the displacement which it was causing in the processes of civilization. Such an 'Economic and Social History of the World War', it was felt, if undertaken by men of judicial temper and adequate training, might ultimately, by reason of its scientific obligations to truth, furnish data for the forming of sound public opinion, and thus contribute fundamentally towards the aims of an institution dedicated to the cause of international peace.

The need for such an analysis, conceived and executed in the spirit of historical research, was increasingly obvious as the war developed, releasing complex forces of national life not only for the vast process of destruction but also for the stimulation of new capacities for production. This new economic activity, which under normal conditions of peace might have been a gain to society, and the surprising capacity exhibited by the belligerent nations for enduring long and increasing loss—often while presenting the outward semblance of new prosperity—made necessary a reconsideration of the whole field of war economics. A double

obligation was therefore placed upon the Division of Economics and History. It was obliged to concentrate its work upon the problem thus presented, and to study it as a whole; in other words, to apply to it the tests and disciplines of history. Just as the war itself was a single event, though penetrating by seemingly unconnected ways to the remotest parts of the world, so the analysis of it must be developed according to a plan at once all-embracing and yet adjustable to the practical limits of the available data.

During the actual progress of the war, however, the execution of this plan for a scientific and objective study of war economics proved impossible in any large and authoritative way. Incidental studies and surveys of portions of the field could be made and were made under the direction of the Division, but it was impossible to undertake a general history for obvious reasons. In the first place, an authoritative statement of the resources of belligerents bore directly on the conduct of armies in the field. The result was to remove as far as possible from scrutiny those data of the economic life of the countries at war which would ordinarily, in time of peace, be readily available for investigation. In addition to this difficulty of consulting documents, collaborators competent to deal with them were for the most part called into national service in the belligerent countries and so were unavailable for research. The plan for a war history was therefore postponed until conditions should arise which would make possible not only access to essential documents but also the co-operation of economists, historians, and men of affairs in the nations chiefly concerned, whose joint work would not be misunderstood either in purpose or in content.

Upon the termination of the war the Endowment once more took up the original plan, and it was found with but slight modification to be applicable to the situation. Work was begun in the summer and autumn of 1919. In the first place

a final conference of the Advisory Board of Economists of the Division of Economics and History was held in Paris, which limited itself to planning a series of short preliminary surveys of special fields. Since, however, the purely preliminary character of such studies was further emphasized by the fact that they were directed more especially towards those problems which were then fronting Europe as questions of urgency, it was considered best not to treat them as part of the general survey but rather as of contemporary value in the period of war settlement. It was clear that not only could no general programme be laid down *a priori* by this conference as a whole, but that a new and more highly specialized research organization than that already existing would be needed to undertake the Economic and Social History of the War, one based more upon national grounds in the first instance and less upon purely international co-operation. Until the facts of national history could be ascertained, it would be impossible to proceed with comparative analysis ; and the different national histories were themselves of almost baffling intricacy and variety. Consequently the former European Committee of Research was dissolved, and in its place it was decided to erect an Editorial Board in each of the larger countries and to nominate special editors in the smaller ones, who should concentrate, for the present at least, upon their own economic and social war history.

The nomination of these boards by the General Editor was the first step taken in every country where the work has begun. And if any justification was needed for the plan of the Endowment, it at once may be found in the lists of those, distinguished in scholarship or in public affairs, who have accepted the responsibility of editorship. This responsibility is by no means light, involving, as it does, the adaptation of the general editorial plan to the varying demands of national circumstances or methods of work ; and the measure of success attained is due to the generous and earnest co-operation of those in charge in each country.

Once the editorial organization was established there could be little doubt as to the first step which should be taken in each instance toward the actual preparation of the history. Without documents there can be no history. The essential records of the war, local as well as central, have therefore to be preserved and to be made available for research in so far as is compatible with public interest. But this archival task is a very great one, belonging of right to the Governments and other owners of historical sources and not to the historian or economist who proposes to use them. It is an obligation of ownership ; for all such documents are public trust. The collaborators on this section of the war history, therefore, working within their own field as researchers, could only survey the situation as they found it and report their findings in the form of guides or manuals ; and perhaps, by stimulating a comparison of methods, help to further the adoption of those found to be most practical. In every country, therefore, this was the point of departure for actual work ; although special monographs have not been written in every instance.

This first stage of the work upon the war history, dealing with little more than the externals of archives, seemed for a while to exhaust the possibilities of research. And had the plan of the history been limited to research based upon official documents little more could have been done, for once documents have been labelled ' secret ' few Government officials can be found with sufficient courage or initiative to break open the seal. Thus vast masses of source material essential for the historian were effectively placed beyond his reach, although much of it was quite harmless from any point of view. While war conditions thus continued to hamper research, and were likely to do so for many years to come, some alternative had to be found.

Fortunately, such an alternative was at hand in the narrative, amply supported by documentary evidence, of those who had played some part in the conduct of affairs during the war, or who,

as close observers in privileged positions, were able to record from first- or at least second-hand knowledge the economic history of different phases of the great war, and of its effect upon society. Thus a series of monographs was planned consisting for the most part of unofficial yet authoritative statements, descriptive or historical, which may best be described as about half-way between memoirs and blue-books. These monographs make up the main body of the work assigned so far. They are not limited to contemporary, war-time studies ; for the economic history of the war must deal with a longer period than that of the actual fighting. It must cover the years of ' deflation ' as well, at least sufficiently to secure some fairer measure of the economic displacement than is possible in purely contemporary judgements.

With this phase of the work the editorial problems assumed a new aspect. The series of monographs had to be planned primarily with regard to the availability of contributors, rather than of source material as in the case of most histories ; for the contributors themselves controlled the sources. This in turn involved a new attitude towards those two ideals which historians have sought to emphasize, consistency and objectivity. In order to bring out the chief contribution of each writer it was impossible to keep within narrowly logical outlines ; facts would have to be repeated in different settings and seen from different angles, and sections included which do not lie within the strict limits of history ; and absolute objectivity could not be obtained in every part. Under the stress of controversy or apology, partial views would here and there find their expression. But these views are in some instances an intrinsic part of the history itself, contemporary measurements of facts as significant as the facts with which they deal. Moreover, the work as a whole is planned to furnish its own corrective ; and where it does not, others will.

In addition to this monographic treatment of source material, a number of studies by specialists is already in preparation,

dealing with technical or limited subjects, historical or statistical. These monographs also partake to some extent of the nature of first-hand material, registering as they do the data of history close enough to the source to permit verification in ways impossible later. But they also belong to that constructive process by which history passes from analysis to synthesis. The process is a long and difficult one, however, and work upon it has only just begun. To quote an apt characterization, in the first stages of a history like this one is only 'picking cotton'. The tangled threads of events have still to be woven into the pattern of history ; and for this creative and constructive work different plans and organizations may be needed.

In a work which is the product of so complex and varied co-operation as this, it is impossible to indicate in any but a most general way the apportionment of responsibility of editors and authors for the contents of the different monographs. For the plan of the History as a whole and its effective execution the General Editor is responsible ; but the arrangement of the detailed programmes of study has been largely the work of the different Editorial Boards and divisional Editors, who have also read the manuscripts prepared under their direction. The acceptance of a monograph in this series, however, does not commit the editors to the opinions or conclusions of the authors. Like other editors, they are asked to vouch for the scientific merit, the appropriateness and usefulness of the volumes admitted to the series ; but the authors are naturally free to make their individual contributions in their own way. In like manner the publication of the monographs does not commit the Endowment to agreement with any specific conclusions which may be expressed therein. The responsibility of the Endowment is to History itself—an obligation not to avoid but to secure and preserve variant narratives and points of view, in so far as they are essential for the understanding of the war as a whole.

J. T. S.

AUTHOR'S PREFACE

THIS work suffers inevitably from the fact that it is the product of disjointed fragments of leisure—a sometimes jaded leisure—over a period of ten years, and the picture of it, as a whole, has often been absent from my mind for many months.

But in this matter of time it gains from two facts: first, that the bulk of it was written while the proceedings were fresh in mind, with full access to contemporary notes and documents and with every check against *ex post facto* wisdom or romance; second, that in the process of revision and a long retrospect, certain corrections of perspective and emphasis became possible, as different factors took up a new relative importance, with the disappearance of the personal equation.

In the matter of authority, the record ought to benefit from the fact that the writer of it took a prominent personal part in nearly all that is recorded and was in constant contact with all the Chancellors of the Exchequer and Financial Secretaries to the Treasury during the period from 1914 to 1920. I was busy with the inception of most of the actual and most of the abortive schemes and changes, busy with their legislative programme and history, busy with the administrative aspects of many of them. I recorded my views, and the manuscript evolutionary attempts are preserved. So the story has the eyewitness quality. But it almost certainly has still too much of the personal equation. What appealed to me as important and interesting at the time will have survived in some form; what was passed over as insignificant then, will not so surely have been restored, revived, and preserved since.

It is possible to study the subject in one or both of two ways. First, later generations may be most interested in the social and political psychology of the development of war finance. How did the public mind meet each new shock, each unfolding of the expectation of new burden? Was it active in initiation or sullen

and passive before the inevitable? Did its patriotism cover its pocket? Was there solidarity of the social classes? All these questions demand a chronological method, and an orderly telling of the story as it happened. But such a record may give only a poor idea of the changes and schemes as a whole, detached from their development and their psychology. The two methods are not wholly distinct, and in attempting both one must be guilty inevitably of repetition. But in the first part I have tried to give the authentic reactions of men's minds to events, and in the second a descriptive and explanatory account of particular matters dealt with as a whole with little regard to their development in time.

The pages have not been burdened with hundreds of footnotes. Hansard references should not be difficult to locate, by the general chronology. Other press and private sources are merged in the narrative.

I can only thank the Carnegie Foundation for an infinite patience, and trust that as the story may be new to a rising generation, and now forgotten by the older, it will not have lost everything of value by being such an unconscionable time in getting itself born.

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PART I

CHAPTER I

THE FOUNDATIONS. THE BRITISH OUTLOOK AT THE OUTBREAK OF WAR

THE attitude of the nation towards war taxation cannot possibly be appreciated without a preliminary attempt to understand the pre-war situation. Just as France was caught by the war wholly unprepared with a developed or expansible system of direct taxation, or indeed with any modern machinery, so Britain had been through an experience which put her in a fair way to meet any sudden demands on elaboration of principle or administrative machinery. After the great Liberal victory at the polls in 1906, the machinery of direct taxation had been overhauled, the principle of progression frankly accepted by the adoption of the super tax, and demands for social legislation had led to substantial peace-time increases in the rates of death duties and income tax. A prolonged parliamentary battle over the land values duties from 1909 to 1911 had brought taxation into the foreground, as a political question, and people's minds were as much 'on edge' on taxation problems as upon any questions of the day.

Mr. Lloyd George had been Chancellor of the Exchequer for six years, and while the enormous Liberal majority behind him had been reduced from 356 to 126 by the elections which were precipitated through the House of Lords' action upon the land values duties, he was supreme in his parliamentary power and personal prestige. The super tax was a successful impost and the weaknesses of the new land taxes were in the realm of prophecy only. His fifth budget in 1913 was, after the preceding storms, a humdrum affair—to use a term which the journalism of budget day has consecrated. The trade boom starting in 1910 was still in progress, and budget revenue was being underestimated. Eastern Europe was disturbed, it is true, but England was not apprehensive. The Chancellor spoke of the budget of £195,640,000 as 'colossal', and 'gigantic', but his comparisons with fifty years earlier dissipated any real alarm. The 'sterile' expenditure on

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armaments had risen from £28½ millions to £74½ millions, but this he said depended on the 'concerted or competitive will' of the nations as a whole, and he was generally, in the debates, sceptical as to the likelihood of any relaxation in the growing expenditure for war purposes. On the whole, however, the note of the taxation problem was abounding prosperity and growing taxation for social purposes.

The year 1914 showed little abatement in trade activity, but Mr. Lloyd George's sixth budget, as the first upon which the war was financed, is worth closer study.

In opening his budget speech on the 4th May 1914, Mr. Lloyd George was able to survey the past year as a year in which the trade of the country had reached the highest point on record, and unemployment had touched the lowest point that it had ever reached in the history of the country. He found this all the more gratifying inasmuch as there was hardly any other country in the world which could put forward the same claim. The budget for 1913-14 had reckoned upon an increased revenue of just over £6 millions, but as a matter of fact, he had received £9,441,000—'an increase without any precedent in the history of the revenue of the country'. There had been a deficit expected of £815,000, which was to be met by taking £1 million out of the Exchequer balances. £1½ millions had been taken from the 'old sinking fund' to strengthen these balances for naval contingencies, inasmuch as the result was due to under spending on the navy. In the result, however, the revenue had covered the supplementary excess of over £3 millions, and had made a surplus of £750,000 after leaving the £1 million still to strengthen the Exchequer balances. The historic budget of 1909, with all the feelings and controversy that it had aroused, was still fresh in all minds, and it was a natural point of political honour with the Chancellor to give an account of the progress of the proposals of that budget. The yield from the new taxes then imposed had reached the figure of £27,215,000. It had been proposed in 1909 that the taxes raised should be allocated first for the navy, next for old age pensions, including paupers' pensions, next, the improvement of main roads, and then a development grant especially for agriculture. Following upon that, provision was to be made for

fitting up and financing Labour Exchanges, and for National Insurance, and lastly for the relief of local taxation, which included a national valuation for rating purposes. He claimed that the revenue had proved ample up to that year for the whole of these purposes, except the last, which was really the carrying through of a scheme for the readjustment of local taxation. But naval expenditure had undoubtedly greatly exceeded all anticipations, for the forecast for 1909 was that the expenditure would reach £44 millions during a time of very abnormal shipbuilding, and that after that it would revert to about 40 millions. Unfortunately, however, for that original basis, there had been an increase in shipbuilding programmes abroad: 'There was the Continental situation which had to be taken into account, and the anticipations which we formed then we could not realize.' He claimed that it was for that reason that, instead of making proposals for the relief of local taxation on a liberal basis, without any fresh taxation, he would now have to increase the general burden.

The expenditure for 1914-15 was to be increased by £8½ millions—the navy being responsible for £2,700,000 and the army for £539,000. The outlook for trade was a little uncertain. Some thought that a definite sign of slackness had set in, but his conclusion was that even if there were a depression it would be a shallow one, and would not last long. The total tax revenue was estimated to be £164,875,000, the non-tax revenue £35,780,000, bringing up the total to £200,655,000, or an increase of £2,412,000. The expenditure was to be £205,985,000, leaving a deficit of £5,330,000 which had now to be met.

Mr. Lloyd George devoted the greater part of his speech to a discussion of local and imperial finance. He said that the readjustment of the relations of local and imperial finance was long overdue, for the conditions of local finance had been admitted for many years on all hands to be a crying evil, imposing grave injustice on individuals, and inflicting serious injury on the highest interests of the community. Many most emphatic pledges had been given by the leaders of all parties to deal with it, and deal with it immediately. From the Commission of 1896 it had been an important problem, never properly touched, and

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health was through the obsolete and futile method of the '*mandamus*'. Then followed words of great interest in the light of subsequent experience with Poplar: 'The idea that you could *mandamus* the whole of the members of a municipal corporation that is levying rates of nine, ten, or eleven shillings in the pound because they really cannot face the problem of finding another 2*d.* or 3*d.* is a thing that no Local Government Board has ever been able to bring itself to the point of doing.' As he passed under review the remaining grants for tuberculosis, for nursing and laboratories, for education with all its ancillary services, and for insurance with a number of recent modifications, one felt that the whole of the local services through national expenditure were undergoing a revision. The additional expenditure entailed by Imperial grants was £4,218,000, which, when added to the previously disclosed deficiency, with a margin, made a total of £9,800,000 to be found by new taxation. He said that the best method of equalizing the burden was by means of a graduated income tax, and he quoted the income taxes in Germany as being the most useful weapons for the purpose of assisting the local authorities in their local expenditure. In Berlin the income tax was 1*s.* 9½*d.* in the pound; in Kiel 3*s.* 0*d.* in the pound. It was often forgotten that in this country what was equivalent to a 9*d.* in the pound income tax went for local purposes. About £27 millions went from the Exchequer which in Germany was regarded as for purely local purposes, and that was equal to an income tax of 9*d.*

Earned incomes up to £1,000 were to be left alone, and from that point to £1,500 the rate was to be 9½*d.*; from £1,500 to £2,000, to be 1*s.* 0*d.*; from £2,000 to £2,500, 1*s.* 2*d.*, and from £2,500 to £3,000, 1*s.* 4*d.* The super-tax limit was to be lowered from £5,000 to £3,000. The rates on unearned income and on all incomes above £3,000 was to be raised from 1*s.* 2*d.* to 1*s.* 4*d.* He pointed out that when people talked about 9*d.* and 1*s.* 2*d.* in the pound income tax there were not very many who actually paid it, e.g. a person with £180 had a 'rate' of 9*d.* but as a matter of fact, after taking into account his abatement, he was only paying 1*d.* in the pound, and a person with £400 was only paying 5*d.*, the full rate not coming into force until £701 was reached.

The allowance for children was to be doubled where the total income was under £500. The old allowance in respect of repairs to property, which had been altered in the Act of 1909, had not cost as much as was expected, and the limit of 25 per cent. was abolished. For super-tax purposes the first £2,500 was exempted, and 5*d.* in the pound was charged on the next £500. After that, there was a charge of 7*d.* on the next £1,000; 9*d.* on the following £1,000, and 11*d.* on the next; 1*s.* 1*d.*, 1*s.* 3*d.*, and 1*s.* 4*d.* on the successive 'slices', the net effect being that the £3,500 man paid 1*s.* 7*d.* in the pound in addition to his ordinary income tax; the £4,000 man paid 2*s.* 4*d.*; £5,000, 3*s.* 7*d.*; £10,000, 8*s.* 9*d.* The man with £100,000 was 'let off' with 15*s.* 3*d.* It was anticipated that the new super taxes in a full year would realize £7,770,000, but the yield for the forthcoming year was to be £2½ millions only.

He proposed to bring under charge income that accrued abroad and was not brought home, and from this £1 million was expected in a full year. I am now free to admit that the basis of this estimate, for which I was mainly responsible, was very precarious. It consisted in taking the difference between the gross income believed to accrue to us on the current estimates of capital invested abroad, and the income believed to be subject to tax already, and computing an average rate of duty thereon. Under the heading of Death Duties he proposed to add 1 per cent. on the estates over £50,000 up to £250,000, and from that point the scale was steepened until instead of a maximum of 15 per cent. there was a maximum of 20 per cent. This was expected to realize £3 millions in a full year. Special allowance was to be given for quick succession where the estate came under duty at rather short intervals. The settlement estate duty was to be taken away altogether. In his final balance sheet these additional taxes for the year came to £8,800,000. It was confidently expected that the navy estimate would be reduced the following year, when the period of abnormal shipbuilding would be past. But for the current year he proposed to take the amount required, a further million, from the sinking fund. Since that Government had come into power they had repaid indebtedness to the extent of £104 millions, and by the following year, unless there were a substantial reduction in the sinking fund, it would

reach £114 millions—quite without precedent in the history of any administration. He said they were not justified in imposing fresh taxation to keep up such an unprecedented rate of liquidating their debt, therefore they proposed to take £1 million from that fund, and next year a more substantial sum in order to make up the budget deficiency. He concluded by referring to the gradual but distinct change that had been taking place in the relations between direct and indirect taxation. A few years before total revenue had been practically equally divided between them, but under the taxes then being imposed the percentage of direct taxation would be over 60 per cent. ‘I claim that in the proposals that we have put before the committee we are honourably fulfilling the pledges which have been repeatedly given by the Prime Minister and others, and I claim more, that we are taking a decisive step forward along the road which leads to greater happiness and efficiency for the people of this country, and to greater and more enduring strength and honour.’

Thus in a speech which a critic said was distinguished rather ‘for length than lucidity’, the country was committed, in spite of its unparalleled prosperity and the passing of the ‘Continental situation’, to a (peace) record standard rate of income tax of 1s. 4d., a steep progression in direct taxes, and a vague and far-reaching reform of local expenditure, and the highly contentious expedients of site-value taxation. It was thus a really ‘radical’ budget, but the many misgivings with which the Conservative press was filled were faithfully reproduced in the subsequent parliamentary discussions.

The succeeding debate is interesting to us in the light of subsequent events, for there is a frequent reference to the possibility of war, without anything, however, that can be clearly regarded as a feeling of its imminence. There is no real ring of urgency or apprehension, and the constant harping upon the subject arose because the old idea about the reliance upon income tax in time of war was a conventional stick with which to beat the Chancellor. Further evidence for this view is to be found in a debate upon ‘Food Supplies in Time of War’ which intervened between the budget resolutions and their report, and in which the attendance was so meagre that the House was nearly

counted out. Speaking as an ex-Chancellor, Mr. (now Sir) Austen Chamberlain regretted that there would be a loss of credit and of elasticity 'which may cause us deeply to regret that we can no longer echo the boast of our predecessors that one of our greatest reserves for any international struggle that we should be involved upon, is the reserve of credit which our financial system gives us'. The only reserve for war then left, was the raising of food taxes—'I think not a very happy reserve for a great war. Opinions differ amongst us as to the part which food taxes should or might play in our system of taxation, but war, which was a naval war as well as a land war, would be a bad moment to choose for an increase of the food taxes—just that moment when our food supplies would be threatened, the quantity of them might be reduced, and the cost of them certainly be raised.'

Mr. Sidney (now Lord) Arnold endeavoured to rebut the contention regarding this 'reserve for war expenditure'. 'The cost of war when it comes is generally met by loans and not from current revenue. The real reserve is ability to borrow.' He thought that in comparison with other European powers, 'and particularly with those countries which it is at all necessary to take into account in this connexion', Great Britain was relatively in as favourable a position to borrow as during the Boer War, especially having regard to the recent considerable reduction of the debt. Others followed this point by saying that if the country had to rely, in such cases of emergency as war, on getting through entirely on credit, 'surely it behoves us to take special care to do nothing which may destroy the credit on which we are to rely'—meaning, of course, that such a budget as this was in itself an injury to credit. The budget total had doubled in eighteen years, and they ought to consider what was to be done to meet the requirements of the next few years if such a rate of increase went on as normal; 'quite apart from a national emergency—a great European war—it would be a serious problem for the country to find taxation for ordinary purposes'.

The bearer of a name honoured in national finance, Mr. Hicks-Beach, said, 'here we are at the present moment in a time of profound peace to all outward appearances, tending to destroy

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the most ready resource in time of emergency'. Mr. Hayes Fisher, who had been Financial Secretary to the Treasury some ten years previously, took up the argument that it was unnecessary, when piling up burdens upon the income-tax payers, to reduce the debt, because in case of emergency or real peril 'all the taxpayers from the richest to the poorest, will come to your rescue and provide you with money for carrying on the war'. He assumed that the Government found themselves at war, and had to raise a sum of £230 millions to conduct that war, in face of the new rates of tax running up to 2s. 7d. in the pound. 'Where is there margin for getting any taxes out of the rich?' 'In what form would the money be found?' 'Is it by increasing the tobacco duties, already intolerably high? Is it by increasing the taxes upon beer and spirits?—they would find the consumption very rapidly falling off and themselves defeated in their intentions.' In addition to the Chancellor's vice of raiding the sinking fund, there was another more terrible—the proposal to bridge that 'gap' foreseen for the following year by insisting on a reduction in the naval estimates. 'A more dangerous doctrine was never enunciated, when he knows nothing of the circumstances of the past year, nothing of the condition of European affairs.' The idea that the poor could come to the rescue was criticized 'because in time of war labour would be less in demand, and wages would be smaller . . . you are leaning on a broken reed'.

Others referred to the income tax as the 'great reservoir' being taken away in the event of an unforeseen war. Mr. Chaplin quoted Gladstone's eulogy of the income tax. 'This colossal engine of finance, an engine to which you may resort, and with which, if you judiciously employ it, you can, if need be, defy the world.' . . . 'The times when the language of violence is let loose, and the plains are besmeared with carnage, are times in which the mighty engine may again be made available for the defence and salvation of the country.' He then begged the House to remember that it was a time of general disquiet and unrest—the whole world in arms a matter for very grave and serious consideration.

Mr. Lees-Smith urged that in time of emergency we should not

depend upon this or that particular tax, but upon our total stock of wealth. The simple test by which one could measure whether this reserve was being increased or exhausted was to examine the total wealth not taken by taxation, which he computed to be £1,747 millions in 1904-5 or £41.2 per head as against £2,020 millions in 1914 or £43.11 per head, thus showing the country to be in a stronger position than ever in its history.

There were not wanting those who preferred to make no direct reply to these criticisms, but rather to question their underlying assumptions. 'So long as we think it necessary to spend nearly half our income in defending ourselves against enemies who never come near us the argument is incomplete. . .' (Sir W. Byles). Another member was disposed to doubt whether the Government had been 'industrious enough in seeking to spread more widely and effectively, the doctrines of peace amongst the nations of Europe'. Mr. Lloyd George said the real reserve they had made for war was to wipe off £115 millions of debt since his Government had been in office 'although I do not see why we should always be contemplating the prospect of quarrelling with our neighbours' (11th May 1914). He objected to the view that expenditure on social improvement was extravagance, and that the only economic expenditure was in the 'old ruts' of army and navy estimates.

Closely following this line of argument came the contention that the income tax had become in itself an intolerable burden, or a tax which would fail to 'stay where it was put'. A now familiar plea was raised in a very definite form; 'the heavy income tax was not paid by those on whom it was intended to fall but was increasingly being treated as an ordinary business charge, as a cost, and passed on to the consumer'. This was the 'diffusion' theory in its crudest form.

There was naturally great play upon the utterances of ministers in former years. The Prime Minister (Mr. Asquith) had said when Chancellor of the Exchequer in 1906: 'I do not hesitate to associate myself with the declaration of more than one of my predecessors that income tax at a uniform rate of 1s. 0d. in the pound at a time of peace is impossible to justify. It is a burden on the trade of the country which, in the long run, affects not

only profits but wages.' 'It is open to the same objection as the continuance, at an abnormal figure, of the floating debt, namely that it tends to destroy or at any rate contract a most readily available resource on which the State can draw in a sudden or unforeseen emergency.' His defenders were at pains to show that the word 'uniform' connoted a protest against the taxation of earned and unearned income at the same rate, prior to the differentiation introduced in 1907.

Again, had not the Chancellor (Mr. Lloyd George) on a former occasion, criticized a Unionist Chancellor in most emphatic terms? 'A shilling income tax in times of peace! why it was a war tax in times of peace. They had constant professions calling attention to the danger and yet the peril was increasing . . . they were reaching a point it was difficult for the public to tolerate.' They were 'spending money which was their reserve and which would be useful in case of war'.

The passing of the £200 millions mark for the National Budget was, of course, a rallying point for criticism of an obvious kind. Mr. Snowden said that when he made his prophecy four years before that they were within measurable distance of a £200 millions budget, the forecast was received with derision on all hands. But he ventured to say in ten years' time it would be £250 millions, and they should not be dismayed by the mere size of the figures. They were going to raise during that financial year £100 millions for the payment of past wars and for preparation for future wars . . . 'more than 4s. 0d. per week per family for gunpowder, Empire, glory, and to fill the pockets of the armament ring'. He examined what incomes men would have left after paying this terrible super tax, and found it impossible to say that taxable capacity had been exhausted. How absurd were the jeremiads as to what was going to happen during a time of stress or war, in supposing that the source, upon which prudent Chancellors had relied in times past for such emergencies, namely, the income tax, would be no longer available. 'Why you have got hundreds of millions of pounds available here in the higher ranges of income available for such emergencies or, as I hope, available for much more national and beneficial purposes.'

Mr. Dillon spoke of our expenditure on armaments as mad,

‘because it inevitably incites other nations to strain themselves in the competition in this horrible race’. He believed that the truth would be brought home by the increased duties, which would be ‘more weighty and more valuable in preventing future naval panics than all the speeches’.

Mr. (now Sir) Austen Chamberlain began the first of a long line of criticisms to the effect that not only was the whole burden of taxation becoming intolerable and oppressive, but that it was also too one-sided in its distribution. ‘I do think that we are travelling perilously near that point when, with demands for such an enormous increase of revenue so largely for social purposes, we take our contributions wholly from the direct taxes which exact no contribution from the less well-to-do amongst us.’ He spoke of other injustices of taxation being so enormously magnified, not in arithmetical proportion, but as an increase in geometrical proportion, the anomalies and imperfections that were tolerable with a tax at 8*d.* in the pound becoming very serious with a rate of 1*s.* 4*d.* The student of old budget debates may recall that, twenty years before, Sir William Harcourt had considered the limit of ‘tolerable taxation’ to have been reached upon the income tax rising to 8*d.* in the pound and on the first extension of the estate duties.

In 1914 the history of the gradual transfer of burdens from indirect to direct taxation was a long one. The old rule handed down from 1861—when Gladstone declared that he felt it a duty to pay his addresses to the famous ‘twin sisters’, each with her ample fortune, with impartiality, so that an ‘even balance’ should be kept—was really first substantially departed from by Sir William Harcourt in 1894 on the reconstitution of the estate duties. The higher income taxes of the South African War period took the matter a stage farther, but there was a slight reaction prior to the Liberal budgets of 1907 and 1909–10. By 1913 the percentage of indirect taxation, which had been over seventy when the Corn Laws were repealed, had got down to forty. So far as the actual burden of each is concerned, Sir Bernard Mallet’s records show an increase in the amount of direct taxation from 1888 to 1913 of 134 per cent. against an increase of only 59 per cent. in indirect taxes. In this 1914

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debate the old alarms were raised concerning the effects of increased income taxes and particularly of the economic results of the death duties, in 'spending as income' what was taken from capital. The policy of recent budgets was supposed to be increasing the cost of living: 'While it is true that in direct taxation the burden has fallen heaviest upon the wealthier classes, the cost of living affected by this policy falls heaviest upon the poor.' Mr. Chamberlain particularly objected to the alterations in the death duties with their social effects. In his opinion the budget marked an absolute abandonment of the old Liberal tradition—tradition of economy and minimum expenditure. The Chancellor was so frequently the protagonist of new expenditure that the Treasury could no longer be a department of 'check and control'. 'It is the greatest, most extravagant of all the spending departments.'

The House criticized the policy of increasing taxation to make grants to local authorities, in view of a system of rating reform which depended upon future and complex legislation that must pass the other House also. The Government sought to show that the best part of the work required had been done in the capital valuations of the 1909 land values legislation, over three-fourths being completed, and it was merely necessary to convert these into annual values, from which indeed, the capital values had been largely built up into the new capital values. The additional work required would be very small. But the Chancellor was criticized for asking for £10 millions for grants and giving no clear idea of the purpose for which it was intended.

He replied to the criticisms on this 'confidence trick', that the legislation concerning the application of the money would be in the hands of the Presidents of the Local Government Board and Board of Education, and the Secretaries for Scotland and Ireland, but that clear conditions would be laid down before any distribution, viz. an equitable valuation differentiating between improvements and site values; relief to be given exclusively in respect of improvements, and not of sites; and provisional arrangements for distribution of the money in the meantime. He thought matters would be sufficiently advanced for the money to be distributed in the second half of the financial year 1915.

He commented upon the complete absence of Tariff Reform arguments. While referring to the immense administrative difficulty of interfering with the normal rate of income tax adopted for all purposes of deduction, he announced the decision to keep the incomes under £500 charged at the old rate of *1s. 2d.* and those under £300 at *2d.* less, viz. *1s. 0d.* in the pound, the full cost of the concession being put at £370,000 a year, and the small cost in the current year being taken out of the Exchequer balances. His statement that a considerable amount of work would be caused was challenged and he said he hoped the officials were taking a pessimistic view. 'I am not exaggerating the difficulty in order to find any reason for not doing it, but I am only pointing out the difficulty, in order to show the reason why we hesitated to do anything which would impair the efficiency of one of the best machines and, on the whole, the fairest machine for the extraction of revenue in this country.'

Nearly six weeks elapsed before the second reading debate came on, and it was almost immediately apparent that the Chancellor had found his programme of rating reform impracticable in the time at his disposal, and that all the different pieces of requisite legislation could not be carried through simultaneously. The principle of giving local authorities new revenues for new services became merged with the principle of relieving the burden of rates by grants which were the best substitute for an impracticable local income tax. The Chancellor found that he could not arrange to divide up rateable values forthwith, so he proposed to take powers only for the Land Valuation Office to 'collect information' preparatory thereto. As a matter of fact, although it was not admitted in the House at the time, the original project had been impulsively conceived, and without proper departmental preparation and advice being secured in advance. It would certainly in any case have broken down by its own weight, but resolute parliamentary tactics accelerated the declaration. It followed as a matter of course that certain of the financial grants to local authorities could not be made during the year, and, therefore, that there was no justification for insisting upon the full revenue originally contemplated. The income tax was thereupon raised to *1s. 3d.* only instead of *1s. 4d.* and a

troublesome process of repaying the 1*d.* in the pound deducted in excess from many kinds of dividends ensued in consequence. Great uncertainty existed for some time as to the correct ratio of tax to be deducted from dividends, because 1*s.* 4*d.* was still the legal rate and yet it was declared that 1*s.* 3*d.* would soon be made retrospective in its action. The dividend warrants for the half-year to the 30th June 1914 were being prepared and no one knew whether 1*s.* 3*d.* or 1*s.* 2½*d.* as the average rate should be applied. A triumphant opposition exclaimed, with some justice: 'the great budget of 1914 which was the successor historically and by reputation of the great People's Budget of 1909, and this great budget which was to make history, is crumbling already.' Mr. Walter Long, who had been associated with the abortive Valuation Bill of 1904, made a drastic criticism of the tangled position of the whole question. A couplet was aptly applied:

If so soon as this I'm done for
I wonder what I was begun for.

There had been a month's delay in bringing in the Revenue Bill and the discussion involved apparently four Bills: 'Finance Bill No. 1, what will be Finance Bill No. 2, the Revenue Bill, and they are all to hang on a fourth bill as to which the representative of the Government said he did not know what was in it or would not say if he did.' The original contemplated surplus of £252,000 was changed into an estimated deficit of £144,000.

The second reading debate was carried on vigorously for four days and ended in a division, with 303 against 265. In the main it dealt with the iniquities of the Government in their constitutional procedure, with the operation of the land values taxes of 1909-10, and with rating reform. There were fewer references to the 'war reserve', but many allusions to existing expenditure on armaments. The plea of a Labour member is of interest:

'Here let me say that I think if there is one tribute that can be more honestly paid to this Government than any other it is that in the midst of European complications and great difficulties, Continental and Asiatic, they have at least kept the country clear from war, and to have done so for all these years in the face of such complications is, to my mind, one of the greatest tributes that could be paid to them. But I think they would deserve even a greater tribute to this Government, when conditions

are so promising as they are to-day, with a thoroughly good understanding with our neighbour on the Continent, and when our relations with Germany are growing more amicable day by day, and when we are celebrating a 100 years' peace with the Western States of America, and when, whichever way we look, profound peace prevails, if they could make a step in advance and do something to seek peace and ensue it by reducing the swollen and inflated expenditure on armaments from under which the nation is suffering. That would be the greatest tribute that could possibly be paid to them.'

Another member said:

'We must realize that if this country and the other countries of Europe engage in the tornado and orgy of naval expenditure, it must lead to an increase in the cost of living. Our relations with Germany, which has been held up as the particular enemy opposed to us, and not only with that Power, but also with Russia and France, have never been so happy. When we know that, what in the name of common sense is the object of pursuing this policy of ever-increasing naval expenditure.'

But perhaps Mr. Bonar Law's contribution is the most interesting:

'What would be the position of this country to-day if we were suddenly faced by a great war? Has the Chancellor of the Exchequer ever thought of that? He assumes that they have paid off £100 millions of Debt. They have not. But suppose that they had, that would be an annual saving of £3 millions. They have added an annual outgoing of £50 millions to set against that. What would happen? Where would we get taxation which would raise the revenue that is necessary? Even the Prime Minister told us when he was Chancellor of the Exchequer that an Income Tax of 1s. 0d. in time of peace was something very much to be deprecated. It is from the Income Tax that every one used to expect to get the necessary money in time of war. Where would you get it now? Look at another aspect. At what price could you raise a loan if you were at the beginning of a war? I do not think I can put this more clearly to the House than by giving them a contrast between the price of our national security at the time that the right hon. Gentleman took office and the price at which it stands to-day, and a contrast with the change which has taken place in the same time in the national security of Germany. At the time that the right hon. Gentleman took office Consols stood at 87. They are now at 74, which is a fall of 13 points. In the same time, although Germany in the interval has built up a navy, and as the Prime Minister has reminded us, has built it partly out of borrowed money, while we have not been borrowing. Yet, look at the result. In the same time while our national security has fallen 13 points, the national security of Germany has only fallen 5 points.'

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Mr. Whitehouse: 'What interest does Germany pay?'

Mr. Bonar Law: 'The only answer that I can give to the hon. Member is to say that I think that he is qualifying for a place on the Front Bench. A fall of 13 points, in what in time of war would be our greatest national asset, is the contribution of the right hon. Gentleman to the security of the country.'

The last discussion of finance prior to the outbreak of war was the occasion of the third reading on the 23rd July. There were criticisms that the 'pace has been too hot and may involve very considerable embarrassment in the future'. Mr. Chamberlain said: 'We are getting too near the limit of taxation for the ordinary purposes of peace, if not for the great emergencies of the country.' Mr. Montagu said that out of 1,215,000 income-tax payers, a quarter of a million would still pay a virtual rate of less than 1*d.* in the pound and 775,000 less than 6*d.* in the pound. Others referred the budget to a comparison with the National Income which showed that the burden was not relatively greater than formerly. One member said: 'The great field for economy which statesmen in the future will cultivate, is in the matter of national armaments. Europe's expenditure upon that item is monstrous, and I cannot believe the world can go on spending the proportion of the National Revenue on armaments that we, in these unhappy years, are doing.' Mr. Lloyd George said that it was a serious thing for a leader of a Government, like Mr. Chamberlain, to assume that the expenditure on armaments would be going on and that there was not likely to be a stop to it. He thought there were symptoms, at home and abroad, that financial interests were getting alarmed. Armaments could not be arrested by political moves or criticism, nor, regrettably, by motives of humanity, but only when great financial interests began to realize what a menace they were to capital, industry, and property. He devoted a considerable and notable passage of his speech to the possibilities of war:

'It is very difficult for one nation to arrest this very terrible development. You cannot do it. You cannot when other nations are spending huge sums of money which are not merely weapons of defence but are equally weapons of attack. I realize that, but the encouraging symptom which I observe is that the movement against it is a cosmopolitan one and an international one. Whether it will bear fruit this year or next

year, that I am not sure of, but I am certain that it will come. I can see signs, distinct signs, of reaction throughout the world. Take a neighbour of ours. Our relations are very much better than they were a few years ago. There is none of that snarling which we used to see more especially in the Press of those two great—I will not say rival nations, but two great Empires. The feeling is better altogether between them. They begin to realize they can co-operate for common ends, and that the points of co-operation are greater and more numerous and more important than the points of possible controversy.'

He went on to quote the debates of 1842. The Duke of Wellington, in reply to a contention that the income tax was a war tax not to be imposed in time of peace, had said: 'I will not say that we have been at war, but I believe we have been at something as like war, if it be not war, as anything could well be.' Mr. Lloyd George said it was exactly a description of the present situation throughout the world.

'Here in Europe we are spending £350 millions a year upon all this machinery and slaughter. . . . It would make one despair of the common sense of nations to imagine that that state, not of armed peace, but of armament which is equivalent to war, could continue.'

He looked forward to the time when millions could be saved from wretchedness by the re-establishment of sanity and saving the gigantic expenditure entailed for the devices of war.

Mr. Stephen Walsh declined to believe that the army and navy estimates must remain as high as £80 millions when our relations with France were so cordial, 'while with our great kinsfolk across the seas, the United States, and with Germany we are upon improving friendly terms'. Others followed in a similar strain and one defended the increased expenditure on 'upbuilding the poorer sections of the community' on the ground that when the day of battle should come 'this very financial legislation will give you a people more virile, more healthy and more strong . . . it will mean an army corps to you. At the time of the last war you called for recruits and some who were willing to go could not serve because of having been brought up in the slums of the great cities'.

The arguments were, to a great extent, the usual amenities of debate. There was no passion, no conviction, no alarm.

Four days later (17th July) the navy estimates were discussed.

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Domestic detail, rates of pay, prospects of advancement, stagnation in promotion, medical questions, but no hint of the greater call.

As July went out the Finance Bill became law, and closed down a budget which had been hailed, somewhat prematurely as it seemed, as 'historic', but which was really to be historic for reasons quite different and known only to unbosoming time; for it was to be the scheme of taxation that should make a first tiny contribution towards the fast assembling burdens of the war, when during those early months of vocal 'business as usual', 'taxation as usual' was the unexpressed corollary. At the very launching, the distant rumblings of its stormy trial were already upon it.

On Wednesday evening, 29th July, at a little dinner at Claridge's, those who had been the silent official assistants of the Chancellor met him to celebrate the completion of his task,¹ but the occasion suffered unusual interruptions as he retired from the room from time to time in response to urgent and confidential messages, and then returned again and again to throw off a preoccupied gravity which, without apprehension, our quiet comment attributed to 'the serious situation on the Continent'.

The 3rd of August brought questions about food supplies and panic prices and the temporary suspension of Bills of Exchange obligations. No reference to cost or financial burdens was made in the debate on Sir E. Grey's momentous speech. On the 4th the insurance of war risks by the State was discussed. On the 5th the Chancellor outlined the emergency steps taken for meeting currency requirements; on the 6th a vote of credit for £100 millions was moved by Mr. Asquith for the conduct of the war. On the 10th August the House adjourned and taxation had never been mentioned. There was a mild individual protest that the £100 millions credit would remove the conduct of the

¹ There were present, to meet Mr. Lloyd George, the host, Sir Matthew Nathan, K.C.M.G. (Chairman of the Board of Inland Revenue), Sir John Simon (Solicitor-General), Rt. Hon. Edwin Montagu, Sir John (now Lord) Bradbury, Sir Arthur Thring, Mr. (now Sir) Warren Fisher, Mr. (now Sir) E. E. Nott-Bower, Mr. (now Sir) Malcolm Ramsay, Mr. (now Sir) Thomas Collins, Mr. (now Sir) Horace Hamilton, Mr. (now Sir) Andrew MacFadyen, Mr. B. P. Moore, Mr. Chapman, Mr. G. Nicols, Mr. E. H. Strutt, Mr. J. Jacob, Mr. G. P. Kurten (soon to be one of the first victims in the front line), Mr. S. Minnis, and the writer.

war out of parliamentary control for six months. The silence was unbroken by the session that ran from the 25th August to 18th September. So far from any reference to new burdens being made the questions that arose dealt entirely with specific reliefs from taxation due to new conditions. Would claims for relief for earned incomes be refused if, owing to service with the forces, they were delayed after the statutory date, 30th September? Would Belgian refugee children in British homes rank as children for the children's allowance under the income tax? Would the land valuation be suspended during the war to allow the officials to render service? Simple negatives disposed of these questions. Shares were to be valued for probate while the Stock Exchange was closed as at the last date it was open, subject to any changes in value that could be demonstrated. On a third question as to death duties on the estates of those who might fall in the war, Mr. Lloyd George announced his intention of introducing a Bill. 'It would be unjust and unseemly that the revenue should profit by the premature death of those who sacrifice their lives in the service of the country and especially so if it were to the detriment of their widows and children.' The promised Bill was considered on the 28th and quickly passed on the 31st August. On the 26th August he asked for authority for the Treasury to borrow on the security of the Consolidated Fund, as they thought fit. Parliament did not meet again until the 11th November, and the debate on the address, while it dealt with financial expenses in detail, did not touch directly upon taxation. 'Due provision for the effective conduct of the war', in the King's Speech meant, to most people, votes of credit and various forms of borrowing.

The only word upon taxation up to now had been a brief remark from Mr. Austen Chamberlain on the 27th August on the second reading of the War Loan Bill. 'It is quite certain that in a big struggle of this kind the sooner we increase our resources from taxation the better it will be, and I should deplore any delay in appealing to the patriotism of the House and the country to vote the taxes that will be required.' A back-bencher caught this up in his speech on the address. *The Times* had approved this attitude and drawn from Mr. Chamberlain on the 12th November a letter disclaiming that his earlier statement

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necessarily applied to the present state of affairs, by which he meant that failure to bring forward taxation proposals until a later date would not be open to criticism. The critic (Mr. David Mason) said that the ex-Chancellor had, apparently, changed his mind since August on the 'great question' of Taxation versus Borrowing, and he urged that an immediate contribution should be levied, not merely for sinking fund, but towards the general expenses, contending that a loan policy by itself had bad industrial and financial effects. 'No one for a moment would suggest that this war can be carried on by taxation, or even largely by taxation, because of its enormous cost, but, if you have a certain proportion of war supplies derived from taxation, you would bring before the people the fact of what war is, what the expenses are, and this would tend, in the nature of things, to direct men's minds, as soon and as expeditiously as possible, to the possibility of bringing about an honourable peace.' This opening of the subject met with no response. It was swamped by the immediate human element—separation allowances, alien enemies, press censorship, and the like. The popular cry, 'Business as usual', meant by tacit consent 'taxation as usual' too.

CHAPTER II

THE FIRST YEAR OF WAR TAXATION

1. *The First War Budget, November 1914.*

ON the 16th November the second vote of credit was brought up. It was for £225 millions, making £325 millions in all, and was intended to carry up to the 31st March 1915. It included £45 millions for loans, £10 millions being to Belgium and the balance to the Dominions. The cost of the war was estimated at £900,000 to a million pounds per day based upon the experience of 105 days, with a reasonable margin. The discussion upon this vote ranged mainly over such subjects as the payments to dependants, the condition of recruiting, imports of tea and the position of the coal trade, and there was no reference to the imposition of taxes. The next day, however, the Chancellor introduced his war budget.

Mr. Lloyd George said that people had been uniformly underestimating the cost of the war. Separation allowances alone would amount to £65 millions a year. The outbreak of war had had certain effects upon the revenue for which he had previously budgeted, and he estimated that it would be reduced by £11,350,000 from the original figure of £207,146,000. As the total expenditure was estimated to be £535,367,000, the anticipated deficiency was £339,571,000. The highest expenditure ever experienced in war time was £71,000,000 in a year, whereas in the first full year of this war it would reach £450,000,000. During the whole of the Napoleonic wars the expenditure was £831 millions, of which £391 millions were raised by taxes; in the Crimean war £35½ millions out of £67½ millions were raised by taxes. He went on to say that during the Napoleonic wars one-fifth of the national income was taken up in taxes, the proportion being subsequently raised to one-quarter and afterwards to one-third—an heroic action which was saving us to-day 4*d.* in the pound on the income tax.

Mr. Lloyd George quoted from Mr. Gladstone's speech during the Crimean war, upon the spirit of self-sacrifice which must have actuated them: 'why cannot you do that in 1854 which your

fathers did in 1798? What were their means as compared with ours?' Mr. Lloyd George said it was equally true in 1914. He thought it wiser in making his plans to assume that the war would last a long time. It was necessary to find £16 millions in taxation to cover the loss of revenue and the interest on the borrowing for the year, and this additional taxation should be capable of yielding £50 millions in the following year. The revenue must necessarily be annually deprived of some of its supports during war, and it would be profligate and cowardly to borrow for this purpose. Moreover, four-fifths of the money to be raised would be spent in this country.

It is interesting, many years later, to reflect upon his outlook at that time for the future. He looked forward to something like four or five years during which the industries of the country would have the artificial stimulus which would come from the abnormal conditions of war.

'When that period is over, we shall be face to face with one of the most serious industrial situations with which we have ever been confronted. We shall have exhausted an enormous amount of the capital of the world which would otherwise have been available for industry. Our purchasers both here and abroad will be crippled. Their purchasing power will have been depressed, and—let us make no mistake—Great Britain will be confronted with some of the gravest problems with which it has ever been faced. Why do I say that? For this reason: Because I want to impress upon the Committee with all the earnestness at my command that it is desirable that the nation, during this period of inflation, should raise as much money out of taxation as it can be induced to contribute.'

He would be committing an unpardonable blunder against the higher interests of the country if he did not 'enable people' to contribute towards carrying on the war in which the honour and life of their country were so deeply involved.

He thus laid down the principle of imposing taxes to meet all permanent charges, but he also looked forward confidently to the effect of the war in the reduction of armaments afterwards. But a pension list of ten millions per annum must be anticipated!

There were people who were living in safety through the efforts of others, and he matched the sacrifice of their possessions against the sacrifice of life abroad—one of the earliest of those

parallels between life and wealth that afterwards became so hackneyed and often false. It is difficult in these days to recall adequately how much Russia stood for in our hopes and fears. 'Russia is taxing and taxing heavily in that wonderful spirit of heroism and self-abnegation which Russia is showing all round and which is the marvel of the whole world.'

He was very anxious not to interfere with productive industry, and regarded his function as being like that of 'a coal heaver filling the bunkers—cursed by all as a nuisance, though discharging an essential function'.

His first proposal was to double the income-tax rates, but to do so only from the 1st December. This meant that for one-third of the current financial year the rates would be doubled and, therefore, while the rate for a whole year would be increased by 1s. 3d. in the pound—a normal rate of 15d. in the pound became 20d. for 1914/15. At this step he was so obviously anxious to disarm criticism by stressing the lightness of the new burden, that he embarked upon some proportional statements which rather mystified his hearers and gave rise to slight complications in debate. He said that for the man with an income charged at 9d. there was an additional one-eightieth upon his income and next year three-eightieths; for the man with unearned income there would be an additional contribution of one-forty-eighth and the following year one-sixteenth. The effect of the rebate would be correspondingly enhanced. Introduced thus gingerly it took a little while for the real effect to become apparent. He recognized that in many cases the source of income would be swept away, but he proposed to make special arrangements to meet these hardships. The immediate effect was: £11 millions income tax and £1½ millions super tax for the current year and £38¾ millions income tax and £6 millions super tax for the following year, making a total of £44¾ millions. Coming to indirect taxation, he showed that he had been toying with the idea of a wages tax, but had come to the conclusion that it was too complex and the cost of collection prohibitive. He would thus be compelled to resort to the limited list of sources from which any considerable revenue could be raised.

Beer contained from 9 to 10 per cent. of spirit, and if it were

charged as spirit it would pay £2 7s. 10d. per barrel; whereas charged as beer it paid only 7s. 9d. 'People who drink beer and who do not consider they are drinking intoxicating liquor will be glad to know that light beers contain only from 5 to 7 per cent. of proof spirit—just a little above ginger ale.'

Mr. McKenna, as Home Secretary, had inquired for him into the people's habits in regard to beer drinking and found that the half-pint was the favourite 'call'. This, therefore, formed the basis of his calculations and an extra halfpenny per half-pint would mean a duty of 17s. 3d. per barrel and this would encourage the sale of light beers on which the margin of profit for the trade would be greatest. War conditions had made it essential to introduce various restrictions in the hours of sale, and, in consequence of this, it was necessary to have some adjustments of license duties. From the beer duty—after allowing for these adjustments and brewers' drawbacks, he expected to get £2·05 millions in the current year, and £17·05 millions in the following year. In these calculations he had estimated for a decrease in consumption amounting to 35 per cent.

Coming to the taxation of spirits, he said that three and a quarter gallons of whisky paid £2 7s. 10d., whereas beer would now pay 25s. 0d. He recalled that the result of the increase in the spirits duty in 1909 was that the trade 'reeled for some years under the blow', and said he was not intending to repeat the experiment. Moreover, it was undesirable for diplomatic reasons to have any increase in the duty on wines.

He next turned his attention to the teetotalers. These, he said, were not reached by a tax on mineral waters, for three-quarters of the consumption was by alcohol drinkers and the remainder by children. He was, therefore, driven to the tax upon tea. Despite suggestions for a graduated scale according to quality, since 1836 there had only been one rate, raised to 8d. in 1904, and in 1914 standing at 5d. In Great Britain there was more tea drunk per head than in any country except Australia. Sugar was limited in supply and it was not possible to tax it equitably. It is now a sufficient comment that the duty shortly after became five times as great! But tea prices had been going down and he proposed to add 3d. per lb. to the duty, bringing it

back to the 1904 level. He estimated a 5 per cent. decrease in consumption and the expected revenue was £950,000 in the current year and £3·2 millions in the next.

The sinking fund provision under the Finance Act 1904 was £23½ millions, of which £16¾ millions were for interest and management and £6¾ millions for repayment. In the current year he would derive £15½ millions from new taxes and £2¾ millions from suspending the sinking fund, making £18¼ millions in all. He would then be left with a deficiency of £321,321,000. At this point he outlined his borrowing policy and announced a loan of £350 millions issued at 95. Details of this loan occupied a considerable portion of his speech.

The first reply was—following well-known custom—made by an ex-Chancellor. Mr. (now Sir) Austen Chamberlain explained that three months ago he had thought taxation proposals advisable: again, he might think them advisable in three months' time. Any difference of view was rather as to the *time* of introduction, and he had no difference in principle as to the burden to be borne. His comments upon the income tax were moderate and non-committal, but he was doubtful as to the effect of the beer tax upon the trade. He felt that the tax on tea was regrettable but unavoidable, and laid much stress upon the hard cases that were arising out of the income tax.

In the succeeding debate the new loan came in for much of the comment, but the brewing interests were at once to the fore in expressing doubt as to their ability to bear such a serious burden. The tax was going to inflict something 'very like ruin' or injury on the trader.

Amongst the miscellaneous proposals were the revival of an old income-tax provision which, in any year in which a business was depressed, enabled a new average of three years, including the 'bad' year, to be substituted for the average of three previous years.

A special provision was made for the publicans in Dublin, as well as for the payment of income tax by instalments as a necessity brought about by the tightness of money and the heavy income tax, and by the extreme weight of the rich man's contribution. This concluded the discussion for the first day and the

resolutions for tea and beer were taken in accordance with custom.

The following day an early herald of the 'amusements' tax appeared in a proposal to tax the gate money of football matches, which was negatived by the Financial Secretary.

When the income tax came to be debated the special provision for giving relief in a bad year was elaborated and also the method of carrying super tax over when the income of the year of payment was substantially below the amount assessed.

The beer duty proposals were soon challenged by the trade—'placed in a very serious position'. The propriety of the tax was admitted, but the 'proper margin' between the retailer's price to the public and his own payment to the brewer was in dispute. The increase of 225 per cent. in the duty was unusual and unique and would have results 'of a very grave character'. A trade which in recent years 'had been so harassed as to be reduced in many cases almost to insolvency' ought to have been called into conference before the proposals were made. The proposal could only end in 'financial disaster'. It was thought that the enhanced price, with unemployment, increasing restrictions, and absence of men at the front, would make the estimated 35 per cent. for loss of trade not too extreme a figure. A beer-seller selling six barrels at 11s. profit would have made £3 6s. per week; now a 35 per cent. reduction would reduce it to £1 14s. 6d., the standing charges being the same. This effect had been proved a few years before by the spirit duty under which the trade was 'reeling still'. The retailer's margin was said to be an impossible one. Again, the brewer's profits would be wiped out by the time he had financed the duty (e.g. increased from £3,700 to £12,000) with four months' credit instead of three. To ask the trade to finance £17 to £18 millions extra per year was impossible. Thus ran comment and criticism.

The Chancellor showed himself anxious to meet the objections, and it became a question of fact whether, after allowing for the beers of low specific gravity, a substantial margin existed or not. In committee he said it was clear after further consideration that, in the case of a new concern, a duty of 17s. 3d. would be bearable, but, to give the existing trade time to cut down its

establishment charges and to effect economies on the reduced consumption, he would allow a rebate of 2s. 0d. to 31st March 1916; of 1s. 0d. to March 1917, after which date the full duty of 17s. 3d. should apply. The concession was to cost £450,000 in 1914/15 and from three to four millions pounds in the three years. Mr. Chamberlain had evidently found his co-operation in conferences behind the scenes a little irksome when it came to the debate, but he made it clear that he thought the concession quite inadequate.

Mr. Sherwell suggested a revision of trade credit, and also a re-scheming of taxation according to alcoholic strength as obtained on the Continent, in order to encourage the lighter kinds.

One eminent brewer's comment on the messages he was receiving from traders was rather a setback to the popular generalities about the cheerful bearing of war burdens. The public 'objected to any extra cost', . . . at Portsmouth customers were avoiding beer and the drop in sales was 50 to 64 per cent. Another representative said immediately the war was over there would be 'turmoil among the labouring classes'.

Labour representatives expressed satisfaction that the financial situation was to be boldly grappled at once, but—the increased duty on tea called for special attention. Estimating that two million people had a wage increase not exceeding one pound per week, and adding those who, owing to the absence of the soldiers, were now brought down to that figure, there were three millions. Those would have one pound of tea per week, so that the tax was, in proportion to income, 'worse than the case of the incomes from £4,000 to £6,000'. Here followed a plea to reduce the increase from threepence to twopence and enable the price of the quarter-pound to be adjusted.

Mr. Lloyd George had been surprised to learn how little would be raised by even a heavy tax on mineral waters, and it could never be an alternative to a tax on tea. Sir Thomas Whittaker was certain that teetotalers drank less mineral waters than others. Personally he did not like 'imbibing carbonic acid gas in anything'. Neither did they drink more tea than any one else.

Constructive proposals were few. A tax on reversionary interests was suggested, since life interests in income would be bearing the whole war-tax burden, and the right to pass a part of the extra burden as a charge on the capital funds was urged. Taxes to diminish consumption of aerated waters, which were said to be a very severe handicap in humble homes, would 'save many a child from stomach-ache'. A proposal to tax football matches was coupled with a suggestion that professional football should be discontinued. The way in which farmers were escaping any proper burden was also brought up—and it was shown that even large farmers, having a profit reckoned by statute at only one-third of their rent, paid virtually nothing.

Mr. Watson Rutherford (19th November 1914) seems to have been the first to suggest a levy upon capital. 'If we had a tax on capital instead of a tax upon income, I believe we should get the whole of the money and at once, and we should have got it in the fairest possible manner to the whole community. There are £12,000 millions of property in this country which can pay. A shilling in the pound would produce £600 millions which would pay for the cost of this war. If the war, as I hope it will, is ended within any reasonable period, this would also leave a considerable balance towards paying for pensions.' 'The commissioners could take it in kind in the case of shares'—also in the case of real estate. He thought that the majority of people would gladly pay if they understood that the 'matter was finished with', and that they were not going to have this 'terrible demand on income'.

Mr. Walter Long was almost alone in asserting that too little was being taken and that heavier taxation should be imposed.

In the committee stage the Government resisted a strongly pressed suggestion for allowing the income tax to be paid in two instalments and the various provisions for relieving cases 'hit by the war' were vigorously discussed, with particular reference to people called up for service. An attempt was made to get the remission of death duties which applied on property passing to a widow or lineal descendants and ancestors of persons killed in the war extended to all property, but it was refused on the ground that beneficiaries in such circumstances were hardly

entitled to special consideration in a time of emergency. The first of many attempts was made to get the pay of those serving with the forces exempted from tax, and it was met by the statement that increase of pay was the proper course—a course that had just been followed. The third reading was taken briefly on the 26th November 1914.

The Economist said that this budget was a budget of 'no nonsense' . . . 'There is no dodging, no attempt to impose taxes which will be profitable to certain interests, and therefore popular with a section of the country. We are inclined to think that the simplicity of this Budget has a massive merit to which a more refined and elaborate scheme could not pretend'. There were others, however, who remarked already that the House of Commons was shutting its eyes to the terrific expenditure that was going on, and that some day the millions would have to be provided by the taxpayer.

On the whole the criticism of recent times that we failed to appreciate the financial situation at the earlier stages and to apply drastic taxation soon enough and so avoid undue inflation, has some justification, even if we make every allowance for the absence of any realization that the war would last a long time, but it is doubtful whether Mr. Lloyd George could at this date have been much more emphatic without being unduly alarmist for the psychology of the people. At any rate, Britain compared favourably with the other belligerents, even at this early date.

2. *The Second War Budget.*

Six months elapsed before taxation matters again took the stage. During this period the incidents and accidents of war-time began to give rise to anomalies in the existing system which called for special redress. But it was a period of germination. In February 1915 the question of the increased burden of income tax on officers on active service began its troublesome career. At this time, too, the Chancellor was interrogated frequently concerning an extra income tax on war profits, even to the extent of twenty shillings in the pound on all profits in excess of pre-war profits, but he 'would not anticipate' his financial proposals, and

such matters were 'receiving consideration'. As a corrective to unrest among the workers and to stop increased prices, it was a 'very useful suggestion'. Should 'debts due from people in enemy countries be regarded as bad?' Official evasiveness could only suggest that they be estimated in the usual way. The presence of Belgian refugees began to show its influence—should there be any stamp duty on sales of shares belonging to them? Could private houses lent as hospitals be exempted from taxes? Could donations to the National Relief Fund be allowed as deductions from income? Was the amount payable as wound pensions fixed in the light of their liability to tax? Could stamp duty on the articles of articled clerks who had fallen in the war be remitted in part? The price of shares for the purpose of officers' estates could be taken at some other figure than that given on the Stock Exchange at 30th July 1914, if good reason were shown. There could be no inhabited house duty exemption for officers on active service. An interest that was not entirely unpartisan or non-political was shown in the enlistment of the staff of the Land Valuation Department and the progress of the valuation.

It was considered by the Government an unsuitable time for any income-tax inquiry. There was a good deal of interest shown in the statistics of alcohol consumption and many technical points in relation to industrial alcohol, licences, &c., came up.

In February Mr. Lloyd George estimated the aggregated expenditure by the Allies at £2,000 millions in the year to December 1915, and our own 'could be financed for five years out of our investments abroad'.

These miscellaneous and consequential questions were the only indications of the existence of a growing problem of taxation, until the budget, deferred to the utmost limit of time, was introduced. Mr. Lloyd George at once confirmed the suspicion that a real taxation proposal would not be immediately forthcoming.

He considered the time unfavourable for drawing a budget, and the ensuing two or three months would give a much clearer indication as to the probable direction of the war. Only the

compulsory obligations of the Provisional Collection of Taxes Act induced him to review the finance and make proposals.

For the first eight months the war had cost £360 millions, of which £52,370,000 were advances to Allies and the Dominions, leaving £307,416,000 net. The figure covered purchases of such commodities as wheat and sugar, the cost of which would come back. The first four months cost £102 millions and the second £177 millions net.

He commented on the buoyancy of the income tax. The revised forecast in November 1914 was £53 millions, and the actual yield was £59,279,000; super tax was estimated to yield £8,460,000 and had yielded £10,120,000. These were due to more ready payment on all hands. Customs and Excise estimated at £73,900,000 had yielded £80,975,000; of the surplus of £7 millions, £3 millions came from forestalments, £2,182,000 was due to increased consumption of spirits (represented by 2,900,000 gallons), £530,000 to consumption of beer (17 million more gallons), and £950,000 to consumption of tobacco beyond the estimates.

There had been 512 cases relieved or exempted under the Death Duties (killed in war) Act, the duty allowed being £102,436.

The debt had been raised by £458 millions to a total of £1,165·8 millions. He submitted two estimates for the future, one based on an assumption that the war would continue for six months and another that it would last for a year. No one could say what the probabilities were, and for that reason he thought it was not a time for deciding a financial policy for the whole year.

Spirits would be affected by dilution and the duty was estimated to yield only £23·4 millions; beer £32 millions, practically double the pre-war year; tea £9 millions; wine £2·3 millions. The total estimate for Customs and Excise was £95·2 millions. The income tax and super tax were estimated to increase by £33·6 millions to £103 millions. The total tax revenue was estimated at £235,700,000—an increase of £46,395,000. The non-tax revenue was to be £34,632,000, making a total revenue of £270,332,000, an increase of £43,638,000.

The budget was singularly barren of proposals for alterations or amendments, the chief item being a technical question relating to the assessment of insurance companies, a change which might have come at any time, but was made more substantial as a grievance owing to the increased rates of tax. A suggestion for restricting, in certain cases, the personal allowance for insurance premiums, in the case of endowment policies, was the beginning of limitations upon this privilege. The charge for debt service was put at £30,726,000, or £55,226,000 including the fixed service. In giving an estimate of the cost of the war the Chancellor warned the House that the 'three or four months after the war may very well be more expensive than the three or four months before the end of the war', because of uncompleted contracts, armies in occupation, &c. The cost of a six months' war was put at £786,678,000 and for twelve months £1,132,654,000. The average cost per day (not including advances to Allies and Dominions) was rising from £2 millions to £2·2 millions, or an average of £2·1 millions. Thus a six months' war would leave a net deficiency of £516 millions, and a year's war £862 millions.

Mr. Lloyd George laid stress upon the wealth of Great Britain, but also upon the difficulty of liquefying it for general use, and particularly in financing purchases from abroad—a rapidly increasing adverse trade balance. He thought that the Allies ought to determine what actually was Britain's best service to the combination: first, keeping the command of the seas; second, maintaining a great army consisting of practically the whole population; and, third, bearing the burden of finance for purchases from abroad and provision of munitions. She could do the first and the third, but the second only within certain limits. In setting out different courses of action, he refused to yield to the temptation to bridge the deficiency with 'paper'. The second course was to sell foreign securities—a course to be pursued only carefully and guardedly; the third was to depend on the income of the country. 'Some are making probably huge profits. I have no doubt that it would be perfectly just when we come to consider, if we ever have to do it, what taxes you have to raise or what contributions you have to levy in order to enable you to get through a war lasting two or three years; then it would be per-

fectly legitimate to resort to those who make exceptional incomes out of the war. But even that will not carry us through successfully. The numbers are too limited.' He went on to urge that our people faced the Napoleonic war with a tax of one-seventh of the National Income and ended with a taxation of two-sevenths. He proposed to renew the income tax 'on its present scale' (double the pre-war rates) 'simply giving this warning, that if the war is prolonged it will be the duty of the House of Commons to consider what further contributions the community should make to enable us to conduct through a war vital to the very existence of the Empire'.

The *Spectator* said that this was only a preliminary pronouncement of policy. 'It would have been better if Mr. Lloyd George had said less about the complications of international commerce and confined himself to the broad and simple issue that it is impossible to raise money except out of people's savings or public savings on peace expenditure.' They wished to avoid borrowing abroad. The whole tone suggested a scheme for forcing savings. The workpeople earning double or treble their usual standards would be unable after the war to earn enough to keep themselves in comfort. The *Spectator* said they ought to be taught to save compulsorily, after having at an earlier date urged a universal income tax at a definite percentage of the wage.

The Chancellor's reference to the three possible but rival lines of effort was destined to be frequently alluded to in later years. Mr. Chamberlain rejoined at once that, although the country might not be able to make its maximum effort along the three lines simultaneously, no weakness in the field could be atoned for by strength in finance. He had prophesied for some five years before the war that the nation's taxable resources were being whittled away. He pleaded for greater economies in civil administration and local expenditure. The new taxes on spirits, beer, and wine came in for severe criticism; they were described as an 'excrescence' hastily put on the restriction scheme.

Mr. Chamberlain characterized 'as verging dangerously on cant' the platform argument that the tax on wine was to satisfy the people that the drink of the legislators was being taxed equally with the drink of the people. He asked in what way wine

interfered with the production of munitions, which, rather than actual revenue, was said to be the *raison d'être* of the taxes. The French had not had so valuable a market as our own since 1870 and, therefore, it was legislation at their expense.

Mr. Lloyd George had said some time before when reproached for not acting in the matter of preventing excessive drinking, that one could not move in advance of, or beyond, public opinion. But he was now criticized for going far in advance and also for not paying sufficient regard to the feelings of the trade. He claimed to have consulted them freely and to have been patriotically met. 'I would not call myself a pessimist, but I do not think I have ever indulged in foolish hopes. I feel in every fibre of my being what a serious task we have before us.' In many such words he tried hard to make the House of Commons realize its responsibility, not merely for criticism but for doing something definite to curb this great evil. Mr. Bonar Law said that all parties shared this spirit, but Mr. Lloyd George had created an atmosphere which had its inevitable effect, and had failed to inspire others with his own enthusiasm as to the paramount importance of the question and his own way of handling it.

Mr. Chamberlain had said the proposal as to beer was 'not taxation but annihilation', and Mr. Bonar Law, judging from a flood of telegrams and deputations, was confident that a passion of excitement and resentment would be aroused destroying all the good of these remedies. Mr. John Redmond could not accept the case as put, without the most careful inquiry '. . . it is clear to me that in some places—probably they are very few—and amongst some workmen—I am sure they are very few—there is a slackness and that slackness is due in some degree to the excessive use of drink'. He made a strong plea that the problem should be dealt with by areas in a drastic way and not by taxation—a taxation that would destroy one of Ireland's few remaining industries, with its reaction upon the feeding of cattle and on farming. Countless thousands would be driven out of employment. 'The drop in Guinness' shares amounts already to nearly a million and a half of money.'

Labour members protested against the extreme and *ex-parte* statements that had been made in the White Paper on the sub-

ject—'entirely the evidence of employers or officials'. The workmen's side had never been stated or asked for. Member after member asserted that the Chancellor had made a mistake and been too precipitate in his judgement. 'He is going to say to all those who work in the mines when they come out of the pit choked with coal dust—"you shall not have your pint of beer when you get home", for they were not going to pay 5½*d.* for a pint of beer when they came home from work.'

In the upshot the increased spirit duties were abandoned, and the restriction of the sale of immature spirits was substituted. Mr. Snowden's final comment was typical: no outsider would have thought they were faced with the gravest financial problem which this or any other country could have, for the debate 'had been concerned with the financial interests of one or two very rich distillers', and on the assurance that they should be protected 'all interest in the budget had evaporated'.

Mr. Snowden took up the Chancellor's text as to the existing industrial prosperity and said they were living in a fool's paradise if they did not realize that it was fictitious, for one could always get temporary prosperity by living upon capital. 'We shall have to pay for this later in commercial and industrial depression and a large volume of unemployment.' He claimed that no part of the additional revenue ought to be raised from the wage-earners. A tax on wages properly apportioned would raise only £3 millions. In his view there had been no increase in wages and a 30 per cent. increase in prices, which represented already a very high rate of taxation in itself. He advocated much larger sums being taken from the rich, say 15*s.* in the pound. 'We must reverse our ideas of imposing taxation. In the past we have looked at what we were taking from a man to a great extent regardless of what was left. Now we shall have to say that no man shall be left with more than a certain amount.' The existence of a rich class with enormous spending power was from every point of view a danger to the community. In view of all the enthusiasm and loyalty of which they had heard, no objection could really be raised to heavier taxation. He opposed too much borrowing because it would really come out of wages.

Sir Thomas Whittaker rejoined to Mr. Snowden's taxation

proposals that the large income had its immediate commitments, and also that he was relying upon Mill's dictum at a time when Mill held the wages fund theory. The Chancellor's rejoinder was that the incomes over £3,000 p.a. only aggregated £220 millions and to take three-fourths would not finance the war—it would only give him an extra £120 millions and he would be £850 millions short. This 'light and airy fashion' of taxing the £3,000 incomes did not solve the problem. Life upon mortgaged money gave fictitious ease. The standard of living, which had been going up for the last thirty or forty years at a 'prodigious rate', would perforce be reduced in one way or another. 'It will be a good thing in itself. Had not we better face it at once?'

The obvious reply to this was that the Government had not taken sufficient advantage of the mood of self-sacrifice and economy by their taxation programme. As it was a commonplace of later financial criticism that Mr. Lloyd George did not realize sufficiently early the importance of heavy taxation, it is interesting to find not a few traces of contemporary criticism along these lines. Mr. Godfrey Collins said that the Chancellor of the Exchequer 'rightly stated that the financial resources of this country would be strained to the utmost, not only during the later period of the war, but when in time the wreckage is being repaired. Then would be time to reduce taxation. Now is the time to increase taxation very largely. . . . I regret extremely that the Government have not placed much heavier taxation on every luxury consumed by the people. . . . The horrors of war are known . . . but I am quite convinced that the financial effects have not been brought home to them as a whole'. He illustrated the danger of missing the psychological moment by taking the question of aliens and the question of prohibition, and pleaded for an additional budget after Whitsun. Others were equally severe. Mr. David Mason commented upon the Chancellor's recent speeches. 'So much of it is in the air. Why does he not practice what he preaches, and why does he not offer us some taxation proposals to discuss instead of lecturing us or delivering speeches suitable for the London School of Economics when proposals are made of a practical character?' But Mr. Snowden's speech was also stigmatized as being suitable for that same institution and

one is left in final doubt as to whether the charge was not in the nature of a compliment.

Mr. Goldstone foresaw that a heavy burden of debt interest after the war would be used as a reason for postponing social betterment, all through 'neglecting the psychological moment'. He resented the idea of lowering the standard of living, pushing people back to sweated conditions, 'driving them into houses into which some members would not put their horses or dogs'. The proper course was to take advantage of the fact that every one was 'screwed up to the position of facing willingly any sacrifice'.

A few miscellaneous subjects came in for mention, such as the possible remission of the sugar tax. Then the existence of the Land Valuation Department was a fair debating target, and questioners were not put off by the statement that 1,700 officials were being dispensed with during the year to March 1916. Motors were tearing up the roads, and the burden upon the local authorities was becoming unbearable. The question of exempting officers' pay continually recurred. The capital levy showed some of its earliest signs of life.

Sir Thomas Whittaker suggested a $2\frac{1}{2}$ per cent. levy on capital, raising £250 millions—an 'attractive proposal but very difficult, because it is cash that we want', and the Chancellor emphasized the view that houses were no good to pay for a war. He found it necessary to point out that 'even if you have the whole of the ordinary savings of the country you would not be able to meet the finances of the war.' If the savings could be doubled, say, £800 or £900 millions, it would be of critical importance. The times were favourable for such effort, for the ordinary obstacle of pride, which in normal times prevented 'cutting down', no longer influenced men.

Whittaker urged the stopping of all public work, which should be deferred until the war finished, when employment would be slack. The Chancellor replied that this must apply mainly to new enterprise and not to undertakings that had been begun.

Prior to the budget there had been stray questions in the House on the subject of taxing war profits. The famous case of Spillers and Bakers with an increase in profits from £89,352 in 1913

to £367,868 for 1914 was the original text. The Chancellor was asked 'to make such provision as would ensure heavy graduated taxation of special profits made during war-time' (Sir Leo Chiozza Money).

'Bill' Crooks said the entire population would look for 20s. in the pound. Mr. Snowden said that the profit was due mainly to market opportunities created by the war, and the 'increased increment' ought to be secured. Others wanted the worker to 'share' the profits. Attention seemed to be directed to this source rather because of something inherently unfair or open to attack, than because of any realization of a paramount need of revenue. Many, therefore, emphasized the 'due-to-the-war' aspect. Lloyd George, in his opening speech, touched the subject none too firmly.

Mr. Snowden's advocacy of the taxation of war-profits revolved around the Spillers and Bakers' Case. 'The indignation of the country was brought to boiling-point' by it. Such hyperbole was supported by the reading of letters from representative constituents. Stock Exchange circulars were 'anticipating' the heavy profits that were expected in shipping. One such statement said that a 6,000-tonner should now earn £35,000 to £40,000 per annum. The Chairman of the Court Line had made a speech to his shareholders in which he referred to a recent purchase for £56,000 which had earned £54,000 in freight in a year. Then he turned to woollen goods, wheat, barley, &c., to illustrate the growing evil. As regards farmers, he proposed the immediate taxation of the farmer upon the profits of the year.

Immediately following the budget discussions, on a motion for the adjournment, profit sharing was discussed, when the special taxation or special limitations of profits were considered as alternatives. This really foreshadowed the acute questions which were to arise on the policy of the munitions levy.

Sir Arthur Markham had eagerly desired to hear that there would be a 'tax on the immense war profits that are being made from the necessities of life'—the neglect to impose it was 'an invitation to everybody to rob the public to the utmost'. His argument that the absence of such a tax was giving encouragement to every single manufacturer and dealer to obtain the most

they could from the public, because they knew the profit was going into their own pockets, is in curious contrast with the later contention of business men, after the tax was imposed, that it induced traders to increase prices in order to maintain their profits. He thought all profits in excess of the average earnings of the last three years should be charged. Several people at once pointed out practical difficulties. Mr. J. M. Henderson said that a slump 'nearly always' came just after the end of a war and this might absorb the extra profits. Sir Thomas Whittaker said that extra profits arose from extensions of business quite distinct from the war. Indeed, the difficulty in determining what were war profits was fundamental. He contended that the exact cause of the exceptional profits made by Messrs. Spillers and Bakers was not in the high price paid by the public. The firm had bought wheat early at a low price. If they had bought later at higher prices the public would have paid no less and no more, but the British firm got the profit instead of the Chicago speculators. Mr. David Mason got nearer to the ultimate issue in asking for an immediate tax on the *actual income* of the year.

In this spirit the debate on the budget resolutions concluded on the 12th May 1915, and there was a lull which, considering that the Finance Bill hung in mid air, was unduly prolonged. To a private member's question as to whether the Government were adjusting the social economic and industrial organization of the country to meet the strain of a three years' war, the Prime Minister replied that they were not neglecting the possibility of a long-continued struggle. On the 19th May the House adjourned for Whitsuntide, and before anything further could be done on the taxation proposals there were important political developments due to dissatisfaction with the progress of the war and the production of munitions, and the Coalition Cabinet had been formed (3rd June). Mr. Lloyd George had become Minister of Munitions, and was succeeded by Mr. Reginald McKenna as Chancellor of the Exchequer, with Mr. Edwin Montagu as Financial Secretary.

Parliament did not get to grips with the Finance Bill again until the Committee stage on the 16th June, although, in discussions on the Vote of Credit, suggestions were made for special

taxation, by way of impounding, as a forced contribution to loans, one-half of the excess of individual incomes over the previous year. There was a rejoinder that a special tax on war profits would be capricious and unfair.

‘If the Government could now definitely say that there was going to be a tax of 20s. on all war profits exceeding the average of three years before the war, it would do more, in my opinion, to encourage the workpeople to turn out munitions, than anything else the Government could do.’

The famous Spillers and Bakers’ case, as the current practical illustration, fell back in favour of the King’s Norton Metal Co., which had increased its profits from £37,548 to £131,097, and in the first instance the President of the Board of Trade gave an assurance that the whole question of the limitation of the profits of armament firms was being considered, but, shortly after, the new Chancellor, speaking on the same illustration, extended his reply to the ‘whole question of increased profits’.

Mr. McKenna had no other immediate business than to get Mr. Lloyd George’s budget completed, for which a month sufficed, the third reading being taken on the 14th July. The proceedings in the meantime were of incidental interest only. An attempt was made to extend the death-duty concessions to any one who was killed by ‘act of war’ in view of the experience of aircraft bombs and such recent disasters as the sinking of the *Lusitania*, but it was resisted on the ground that these incidents were accidents happening to people who were not necessarily doing anything for the country. A further attempt to extend these concessions to all collateral relations was met by the contention that the relief was not really to an estate, but to individuals, and some collaterals were getting ‘unexpected advantages’. The question of the effect of drinking upon output was frequently under discussion, and had its reflex in taxation where restrictions were put upon the hours of licensed premises and various claims for relief from licence duties were a natural corollary.

The impatience for special taxation of high profits was growing, but doubts as to whether ‘war profits’ as such could be successfully distinguished were more frequently expressed. Mr.

Snowden said that 'even Tory newspapers are now agitating with a great deal of enthusiasm' and made him feel 'moderate and old fashioned'. Some hankered after a revision of the income-tax average which was going to have anomalous effects on different industries. In Northumberland collieries were losing, whereas in South Wales they were prospering, wool was doing well and cotton was in a serious condition, armaments were booming but 'pig-iron was bad'. The case for assessing on actual profits, including agriculture, was urged. Mr. Montagu, as Financial Secretary, agreed that it was an urgent necessity to find means for such taxation soon, and said that delay was due to making a scheme watertight in the next few weeks. The income-tax method was not good and this tax could not be revised during a war, or even be considered by the promised Commission.

Remission of duty on alcohol used medicinally in hospitals gave rise to sharp cross debating on obvious lines, and the question was settled six months later upon the suggestion of a committee to give the relief by grants from public funds. But the exemption of motor spirit for motor ambulances was readily conceded. The advocates of relief in taxation of sailors and soldiers were untiring in their efforts, and moved their proposals at every opportunity. They asked for it to apply to all with pay up to £400 and pleaded 'justice', complicated forms, and the act of generosity for the risking of life. The cost of this concession was put at £970,000. Then the proposal was to apply the 1914 rates only and this was said to be equal to an increase of pay amounting to £375,000.

The animosity to the land values duty vested itself in a long and ineffective debate, which raised party feelings as to subsequent intentions. The taxes were subjected to searching criticism, with references to 'smashing the machine'.

Across the path of the Finance Bill came its late sponsor, Mr. Lloyd George, dragging in desperate urgency his Munitions of War Bill (23rd June). The workmen were suspending their regulations and made it a condition that profits should be limited. So he began to steal Mr. McKenna's thunder, with a limitation of profits of munition firms to pre-war profits (on a two years' average) plus 20 per cent. thereon. The constitutional

question as to whether this was not a taxing clause to be dealt with by a 'Ways and Means Resolution' was at once raised, and the Speaker of the House definitely regarded the limitation as a *quid pro quo*. Efforts were made to get the Inland Revenue Department made responsible for the machinery of the limitation, especially in connexion with returns, accounts, depreciation, allowances, &c. Misunderstandings about the 20 per cent. began early. Some thought it would allow a 15 per cent. dividend to be increased to 35!

It gave the indefatigable Sir Joseph Walton a cue for demanding in every debate on every subject that all excess incomes less 20 per cent. to cover the 'increased cost of living'—a phrase then unhackneyed—be paid over to the State, with a war tax on wages. The third reading debate was notable in the main for the Chancellor being urged to produce new taxes, and this was an accurate reflection of most of the Press of the country. 'Our severest criticism is that the Bill does not really grapple with the question of the contribution which taxation ought to make towards the cost of the war.' The country would 'condemn the lack of courage in taxing'. Was it fair to ask returned soldiers to pay later on what ought to have been borne in the war? Taxation was also wanted to teach economy to the country which was being allowed to live in a world of financial delusion. At the same time the Chancellor was urged to make no plunges, to 'keep within the limits of the existing system'—all other countries had had to take off their food taxes and ours was the only one whose system had withstood the strain.

Mr. McKenna so far had had little opportunity for expressing his general views upon the financial problem. He discounted the jeremiads drawn from comparison with Pitt and Napoleonic times, and showed that our efforts in *proportion* were not so unworthy. He found 'serious limitations' to direct taxation, for it was very costly to graduate it downwards. Although he was not at all emphatic about prospective taxation, he hoped to take 'reasonable and bold measures' and welcomed such a wealth of prospective support.

The Vote of Credit and the Price of Coal (Limitation) Bill shortly after gave further scope for expression of feeling, calling

forth a promise from the President of the Board of Trade of a tax on 'war profits' and a statement from Mr. Montagu that this 'would come with a larger demand on the people enjoying more and refrain from increasing the burden of those already suffering privations'. It was now freely alleged that the existence of a special tax so that no one would be 'entitled out of the necessities of the nation to make money during the War' would have prevented the stoppage in the South Wales coalfields.

After this there was a lull in public discussion. The House adjourned on the 29th July. The first year of the war was over. During that year the amount of taxation which had been actually paid into the Exchequer was £235 millions, as compared with £193 millions for the peace year immediately preceding, and this is perhaps the most emphatic test of the 'will to taxation'.

CHAPTER III

THE SECOND YEAR. REAL TAXATION AT LAST!

1. *The First McKenna Budget, September 1915.*

PARLIAMENT met again on 14th September 1915, and the Chancellor brought forward his eagerly awaited budget on 21st September.

One press comment on 18th September may stand for a general typical anticipation, 'The direct cost of the war must be met as well as provision made for permanent charges. He must raise at least £105,000,000 in extra taxation. The Customs duties ought to have been raised in May last. The Cabinet has shown no initiative or courage. Beer and spirits have been favoured. There has been much talk of a five-shilling income tax, but that is a figure which certainly ought to be avoided if possible.'

At the Trade Union Congress a resolution was passed condemning the idea of a tax on wages, but this condemnation was contingent upon the scale of taxation on articles of popular consumption like tea and sugar.

The whole setting and background of Mr. McKenna's speech was the recognition that the war would be a long one, waged at a cost that had not hitherto been recognized or realized, together with emphasis on the fact that the time had come when an effort must be made in taxation worthy of so gigantic a task. In his proposals for new taxation he said that he had been obliged to put on one side many possible projects, not because such plans were bad, but because there was a limit to the amount of additional taxation that could be put on at any one moment. In this he seems to have had in mind rather the administrative difficulties than the psychological effects upon the taxpayer. He confined himself, therefore, to proposing such new taxation as was immediately feasible, and foreshadowed that in future budgets some of the projects which had been put aside would be brought forward for active consideration. He was well aware that his introduction of customs duties without corresponding

excise duties would subject him to severe criticism from all his free-trade friends, but his justification was that it was now necessary to have other objects than those of revenue, for it was a good thing in itself to reduce consumption, particularly of imports. Much had been said in public about the importation by Yorkshire merchants or war profiteers of cheap American motor-cars and cycles. The House listened with eager and rather fearful anticipation while the articles to be subjected to tax were enumerated. 'Poor old Charlie Chaplin!' exclaimed Will Crooks, as cinema films were mentioned. Then followed clocks, watches, musical instruments, plate glass, and hats; and hats, indeed, seemed to cause the greatest astonishment. All of these articles were to be subjected to an *ad valorem* duty of $33\frac{1}{3}$ per cent. and the total duty to be derived was estimated at just under £2 millions in the year for the whole list. Under the income tax, an addition of 40 per cent. to the existing rates turned the standard rate of 2s. 6d. into 3s. 6d. in the pound. But as the addition applied to the last half of the year only the total rate became in substance 3s. Perhaps the most important step was the reduction of the exemption limit from £160, at which it had stood since 1894, to £130, and the reduction of the £160 abatement to £120. Hitherto the exemption limit and the lowest abatement had coincided in amount, so that any person with an income reaching to £1 over the exemption limit had an abatement which left him taxable upon £1 only, whereas under the new scheme he was immediately taxable on £11. This sudden 'jump' into liability was theoretically justifiable on the ground that the small amounts of tax hitherto assessable on these incomes were not worth collecting. The assessment upon farmers had up to then been upon only one-third of the rent, taken as a rough guess at their profit year in and year out—but this basis had for a long time been known to be too low, and when Mr. McKenna proposed to raise this conventional proportion to an amount equal to the rent, there was little surprise. The introduction of a system of discharging liability by half-yearly instalments was an almost necessary corollary to the high rates that had just come into force. The new exemption limit brought into charge hundreds of thousands of new taxpayers who were paid

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by weekly wages, and whose ability to bear taxation could therefore hardly be measured by the same annual standard as other taxpayers had enjoyed hitherto. A system of quarterly assessments and collections was therefore introduced. It was already impressed upon the nation that war-time must bring about many changes in the fortunes of individuals, and there were many who, during the year of assessment, were in receipt of income far less than that received during the years upon which their assessments had been based. Any such person whose current year's income was less than four-fifths of the assessment was to be exempt from the additional duties imposed by the Act. Others who were less hardly hit were to have a similar relief but proportionately reduced. The additional rates of tax were estimated to bring in £37½ millions in a full year, but the reduction in the exemption limit less than a million pounds. The reduction of the abatement, with the consequential changes, was to bring in £3,800,000, whereas the charge upon farmers was estimated to increase the revenue by £2¼ millions—a total extra revenue of £44,400,000. The super tax on incomes of over £8,000 was increased so as to bring in £2,685,000 in a full year.

Mr. McKenna then gave illustrations of the effect upon different individuals. He said that a man with £4 per week would pay in four instalments just over £9 4s. for the year, whereas a man with £5,000 a year would pay £1,029, or a virtual rate of 4s. 1½d. in the pound; £10,000 a year would bear £2,529, and the happy possessor of £100,000 a year would pay £34,029, a virtual rate of 6s. 10d. in the pound. He thought that the lot of the last person might, on the whole, not be considered as altogether such a happy one.

The Chancellor then gave a brief outline of his proposed tax upon excess profits. An exempt margin of £100 was to be allowed over the 1914–15 assessment, which of course was based on the three years' profits before the war, and of the remaining excess he proposed to take one-half. He mentioned three limiting conditions. The first was an alternative standard of 6 per cent. upon the pre-war capital, the second dealt with certain businesses, which he supposed did not exceed half a dozen, and which had been carried on continuously for a great many years in peace

time, not with the expectation or the hope, but on the possibility that one day in war time they might recoup themselves for their loss. Such businesses supplying munitions of war and war materials under Government contracts should have a specially determined *datum* line, to be fixed by a tribunal specially appointed. The third feature was an allowance for increased capital at the rate of 6 per cent., but on appeal to a tribunal specially appointed that rate might be increased for such special reasons as rapid depreciation, obsolescence, or the fact that the capital employed was useful for war purposes only. The tax was to be charged for any business account year ending after the 1st September 1914, and before the 1st July 1915. The special reasons for which the limiting date was fixed will be shown hereafter. He stated at the time that it was done in order that the tax should not interfere with the Munitions Act which was bringing under charge the controlled establishments. It was desirable between then and the next budget to have an opportunity of judging the effect of that Act, and so to be able to make proper arrangements in order to dovetail one scheme into the other in the following year. The duty was estimated to yield £30 millions for a full effective year, by which was meant a charge upon a full year for every business liable. Owing, however, to the late introduction of the duty in the financial year only £6 millions was anticipated to be collected during that year.

The Chancellor then touched upon his intention to introduce a change for the assessment of bank deposit interest. Hitherto such interest had been charged upon the individual recipient, but now it was proposed to treat it as other interest was treated and to charge it upon the payer, who would have the right to deduct tax in the ordinary course.

Under the heading of Customs and Excise, the duty on sugar was to be increased from 1s. 10d. per cwt. to 9s. 4d. per cwt. This announcement was immediately greeted with murmurs from the Labour Party, but the Chancellor promised that the increase of duty should not be effective in the usual way in raising the price to the consumer, because the Royal Commission on the sugar supplies was intending to make an adjustment, and to reduce prices so that sugar would go up only by 5s. per cwt. or a half-

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penny per pound. Granulated sugar would thus be 4*d.* instead of 3½*d.* per pound. Then an all-round increase of 50 per cent. in the duty on cheese, tobacco, cocoa, coffee, and dried fruits was proposed. Beer and spirits on this occasion were not to be touched. There were changes in the postal, telegraph, and telephone rates estimated to lead to an increase of about £5 millions. The total estimated revenue on the old basis was £272 millions; on the new basis it would be £305 millions. Mr. McKenna concluded by referring to the continued willingness of the whole people to pay their share. The debate that followed the speech was noteworthy for the almost unanimous recognition of the fact that the time had come for the country to shoulder heavier burdens of taxation. One described it as an endeavour to make some 'worthy contribution' towards the great cost of the war. Only two voices were raised in doubt. Sir Frederick Banbury feared that if taxation were increased to such an enormous degree they would be dealing a deadly blow to the trade and industry of the country. He continued to urge the old idea that before the war the people were already being taxed upon a war footing, and that therefore they had not the same scope for increasing the burden. Another member claimed that they should take a leaf out of the German book, and have less taxation and more borrowing. They would thus avoid creating a feeling of hardship in the country, and after the war was over would be able to determine how the burden might best be borne. But this view was by no means acceptable. Sir William Byles told of a squire who was once planting trees on his estate. A friend asked him why he was planting them, and the squire answered 'to give umbrage to my remote posterity'. By handing over the payment of the war to future generations they would be giving umbrage to their remote posterity. There were others who, looking ahead, thought that even more ought to be raised by taxation.

One does not expect the most mature and well-informed criticism to follow immediately upon the introduction of any budget. The very mild tariff proposal at once aroused fears and alarms. Mr. Healy exclaimed that the Free Trade fetish was dead. Others thought that to sell the cause of Free Trade for so small a return was a game not worth the candle, while the tax on hats,

in particular, puzzled the members. Claims were made at this early stage, which were to be very insistent later, for the special exemption of soldiers and sailors engaged in fighting and in risking their lives—the claim was on the ground, of course, that they were already making sacrifices out of all proportion to any that those were making who stayed at home. The Chancellor was praised for his courage in lowering the income-tax exemption limit. The excess profit duty had, of course, been expected, and therefore there was no outcry whatever. But one member, not indeed noted for his violent views, advocated, even at this early stage, that the whole 100 per cent. of the profits made out of the war should be taken. It was stated that this tax would be a most important factor in mollifying labour, for one of the greatest causes of unfortunate trade disputes was the feeling of the men that the masters were filling their pockets. The little group of land taxers gave ample expression to their views. The existing land taxes were treated as matters of small account, and the Chancellor would find salvation in all his difficulties if he would but resort to the special taxation of land values. The enthusiasts made much play of the ancient land obligation under the feudal system to be the first to defend the realm. There was some criticism of the increased taxation of farmers coming at a moment when they were being specially urged to increase production. The special taxation of spirits in order somewhat to redress the balance against beer was powerfully urged, and was as powerfully rebutted by the Irish party. Mr. Tim Healy said: ‘It seems to me that when we address the House we are like schoolmasters always addressing new pupils.’ Among the positive suggestions for taxation were a proposal that all kinds of glass should be included under the tariff, and other kinds of ‘luxury’. The taxation of hops was especially advocated, and in this debate we also find one of the earliest suggestions for a tax upon amusements. Mr. Lief Jones urged that it was only so far as people were content to give up the consumption of unnecessary commodities that they could really benefit the national finances, and so strengthen the nation for the great strain that was to be laid upon it.

Mr. Tim Healy, in congratulating the Chancellor, said that

they must grin and bear it, and he, the Chancellor, would have the satisfaction of showing to the enemy a practically unanimous House in the face of increased taxation of an enormous amount. The moral effect of that alone was well worth the sacrifice.

Toby, M.P., expressed the general sentiment when he wrote in *Punch*:

‘his mastery of facts was so complete, his explanation so lucid, that the story was as easy to follow as an ordinary nursery tale. Time was during the time of Gladstone at the Treasury, and with his successors in later years, when exposition of a budget was regarded as opportunity for a great oratorical feat. Mr. Gladstone thought nothing of occupying five hours, finishing up with a peroration almost worth an additional penny in the pound on the income tax.

‘McKenna’s speech began without exordium, finished without peroration, and no single sentence rose above the Spartan simplicity of the multiplication table. Cheerfulness was, indeed, the prevailing note of the historic occasion.

‘Fresh burden of taxation imposed enormous—and affects every class from the consumer of half ounces of tea and quarters of a lb. of sugar to the hapless millionaire, who, out of his modest income of £100,000 a year will be called upon to contribute to the State the sum of £34,029.

‘Lloyd George chastised the taxpayer with whips—McKenna lays on with scorpions and yet no murmur is heard.’

The Press reception was very flattering to Mr. McKenna.

The *Spectator* said that all critics were agreed upon the admirable lucidity. It showed great courage, but they were bound to regret that even bolder proposals had not been put forward; the Government might have gone much farther at every point. The total contribution was only £33 millions against £107 millions for a full year, and this budget ought to have been introduced six months before. The excess profits duty was ‘promoted undoubtedly by a Press and Trade Union agitation against the extravagant war profits now being made’.

During a two days’ interval in the debate the Labour Party had time to hold three meetings, and on the renewal of the discussion Mr. Barnes authoritatively represented their views, which in retrospect are of the greatest interest. Mr. Barnes congratulated the country upon the general acceptance of a scheme of taxation upon a colossal scale, because all the world might

know thereby that this country had got its teeth into the war, and that its teeth were going to remain in the war until peace had been restored on a firm basis. He felt that it was an ominous consideration that the new taxes, estimated to yield a hundred million pounds in a full year, would only just pay the interest on the debts owing at the end of the year. He took the view that, if anything, more ought to be raised by taxation and less by loans. Relatively the people at home had not so far felt the war. 'Taking into consideration the privation, suffering, and losses of those who have gone to the front—as compared with their case our burden has been insignificant.' The Labour Party were willing to support the Government in any proposal which might be made for the conduct of the war, so long as the fresh proposals imposed no fresh disparity of taxation as between class and class; secondly, so long as they did not make any needless inroads into the slender resources of the very poor; and thirdly, so long as they did not sacrifice any vital principle or any real interest of the country. It was in the light of these three principles that he criticized the proposals. They thought that the reduction of the exemption limit for income tax was 'a game not worth the candle', when one considered how little duty it brought in, the vast amount of additional work for the staff, and the actual hardships that would be suffered. He showed that by the reduction of the abatement a man with £200 a year would have his tax doubled, whereas a man with £3,000 a year would still be left with £2,475, and, on the principle frequently enunciated by Mr. Snowden that the point in taxation was to consider not how much you are taking from a man but how much he has left, this man had been dealt with more generously than the men with small incomes. The Labour Party welcomed the war profits tax, but it was a tardy recognition by the Government of what they ought to have done long before in assuming control of certain industries, such as the coal-mining industry, instead of allowing the huge profits to accrue. Now the Government proposed to compound a felony by 'sharing in the swag'! His party asked, 'Why should any man, either by increased profits or, say, even by increased wages, benefit financially as a result of the nation's need?' On this principle they suggested that the rate of tax

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should be 80 per cent. At this point Mr. Barnes gave voice to a misapprehension that ran through the debate for a long time, and took a great deal of explanation before it was finally cleared up. He proposed this rate of 80 per cent. because he thought that it would make the tax correspond with the levy under the Munitions Act. Even as he stated it the misunderstanding was a ludicrous one. It had been decided that the factories under control should not be allowed to increase their profits by more than 20 per cent. 'You should "skim off" the eighty per cent. in the case of additional war profits exactly as you do in the case of controlled factories.' It was surprising how firmly rooted this idea remained. Of course, there was in fact no comparison whatever between the burden of the two taxes, even if the excess profits duty rate had been 80 per cent., except at one point. If the profits made before the war had been *exactly* doubled, say from £100 to £200, the excess profits duty would take £80 out of the second hundred, leaving the business with £120. Under the Munitions Act the business retained £120 in any case, whatever the amount of war profits might be, and the similarity ceased immediately if the profits were either less or more than double the pre-war standard. The Labour Party accepted the additional tax on tobacco, but were, of course, against the tea and sugar duty. The very poor people, they thought, had already been too hardly hit by the taking away of young apprentice sons who would have been earners in their homes. They regretted the abandonment of the Free Trade principle, and were afraid that in a tax on motor-cars the Government were merely helping profiteering. The Labour Party concluded by blessing the doctrine of the land taxes, without having, apparently, any clear idea as to how they could be put into practical shape.

Nearly all the other contributions to the debate were individual. No other interest in the House spoke with such a collective voice as the Labour Party. The sporadic contributions included suggestions for taxing wages by means of stamps, which showed very little appreciation of the practical difficulties of the proposal. Great solicitude was shown lest the payments of large sums of duty for the new taxes should 'incapacitate' business capital. From the point of view of pure principle there was very

little criticism forthcoming, there being no scientific method by which it could be determined what proportion of the cost of the war should be paid by taxation during the war itself. But Mr. (now Lord) Arnold submitted that the new taxation imposed should at least come to such a sum as would make the total revenue of the country equal to the estimated peace expenditure of the country after the war was over, and he made the interesting estimate that the pre-war expenditure being £207 millions, the total amount to be raised should be £357 millions, or an increase of £150 millions, and it seemed to him satisfactory that the Government were proposing to raise a total of £387 millions. This, of course, included £30 millions of new taxation on war profits and temporary revenue. He laid some stress upon the fact that, doubtless, there were many of the poorer classes who were distinctly worse off than before the war. Among these there were nearly a million old-age pensioners; some section of the industrial workers, and many railwaymen; post office servants and police—despite their war bonus; the vast majority of clerks; shop assistants; lodging-house keepers—especially on the coast; and the families of many of the better paid artisans who had gone to the war. He asked the House therefore to scrutinize very carefully the additional taxation of the poorer classes, and to give new weight to the increased cost of living which had done so much to neutralize any advantage from war bonuses. He said, ‘As we cannot expect to have a constructive social reform for a long time, I submit that we should make the taxation on the necessities of life as light as possible—you are taxing on the margin of necessities which will tend to reduce the efficiency of the wage earner.’ There were several serious complaints that the Government were not leading the way in showing the country how to economize.

‘It is all very well making these splendid speeches on the necessity for economy and grit, but the Government must go beyond that. What we need on the part of the Government is a lead to the Nation in this matter of national economy. The Nation, as a whole, does not recognize the need for rigid economy; it is a case of pleasures as usual. Every music hall in every town and every cinema show is crowded to overflowing. More is being spent on drink than was ever spent in the history of the country before. Luxury and self-indulgence have increased in this

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country, even in the last ten years. Tobacco is an illustration how the habit of self-indulgence and luxury have grown with us, because the imports have doubled in the last ten years.'

Mr. Russell Rea urged, however, that the country was saving hard :

'not saving in mere minute Lenten penances, but saving in great chunks of expenditure all over the country. Take the amount of money that was spent in this country on sport; that is mostly being saved to-day. Grouse moors are unlet, fishings are unlet; house parties in the Highlands and elsewhere are unknown; even the popular expenditure on football and sport is contracted enormously. Take all the suspended expenditure on anything, not only in London, but all over the country; on holidays—the people of this country have not taken their holidays, and where they have taken them it has been in an economical way. Take the element of dress, a few months after the beginning of the war in the smoke-room of this House, I put to a group of members this question: How many of you have been to your tailors since the war began? Not one of them had been to his tailor. The saving in this country on women's dress is perceptible to any man who has eyes for female attire. They are not running after new fashions, and women of all classes are wearing hats of old date, and even of the last three years.'

Sir Arthur Markham, however, contested this view:

'All I can tell him is that absenteeism is growing. Working men, living to-day in a time of national distress, are travelling in charabancs; picture palaces and cinemas are full, and at the same time the consumption of beer and spirits has largely increased. The country is giving itself far too much amusement in beer drinking and pleasure making than it ought to do, or than they are doing either in Germany or France.'

Sir Arthur Markham complained that the failure of the Government to control coal had cost the public at large not much less than £60 millions.

Sir Alfred Mond (afterwards Lord Melchett) made a slashing attack on the tariff proposals. He refused to believe that they could be seriously intended. He did not know what other explanation there could be except that the Chancellor was carrying out a kind of joke at the expense of his tariff reform colleagues in the Coalition. Because the articles selected were ridiculous the results would be absurd, and the proposals would not achieve what was intended. He was particularly sarcastic about hats and plate glass: 'Is it not lamentable, is it not absurd, that on a

budget of hundreds of millions, at a time of the gravest national crisis, at a time when we want to concentrate all our efforts on winning the war, we should have to spend our time in discussing this absolute folly, this amateur tariff, wrong in incidence and impracticable in execution.'

Others, however, took advantage of this opportunity to press the claims of the taxation of other imports, such as silks and cotton. It was also urged that the time was not politic for increasing the duty upon patent medicines. It was said that the additional tax must necessarily be borne by the consumer, who, in the majority of cases, belonged to the industrial classes. There were the usual special appeals for the taxation of co-operative societies, but one interesting point made was that the Government should secure a substantial tax from all foreigners who had agencies in London, Liverpool, and other places in this country, and who had been making enormous sums out of Government employment, for buying corn and other commodities.

Mr. McKenna, in his reply in the September debate, congratulated the country on the unanimous willingness with which the burdens had been accepted. He said, 'it is without precedent in a great war of any country, that the nation has come forward and literally asked to be taxed. There is no better omen for our final success.' 'I never knew a country like this for its willingness to pay. I do not believe there has ever been such a country in history.' In his reply to the tariff criticism he said that the theory of Free Trade depended upon conditions which must be more or less permanent in their nature; whereas in war those conditions were absolutely gone. The principles upon which the excess profits duty was based were, to him, very simple, viz. to get money for national purposes from those persons who, at the moment, can best afford to pay; a principle which was later on characterized as the 'highwayman's ground'. Mr. Holt claimed that the people who had increased their incomes during the war were people who had shown spirit and enterprise. Mr. McKenna answered the criticism about the taxation of the different classes of the people at different levels by referring to the fact that at any given moment there was only a certain margin of change available to each person without actually

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altering the whole of his scale of expenditure, and therefore a man who had got an excess income for the first time was a man who was not committed to the additional expenditure, and his profits were free. Such income had come to that man in a time of national emergency, and it was therefore capable of yielding a special contribution. The poorer classes, who now theoretically came within the income tax, were well enough looked after by the special allowances for wife and children. He thought that the consuming power of the people was far greater than it had been in 1911, and perhaps the best case of all was that the consumption of wheat by children had greatly increased, and therefore there was no pressure on the margin of their subsistence, because otherwise that would be the first to suffer.

Thus ended the introduction of a budget which, it has been said, was received with 'hilarity', or 'high expressions of good humour', and perhaps some surprise that the burden imposed had not been even greater. Comparisons that had been made by some members with the burdens of Napoleonic times, and also of the American war, were not felt to be very much in point. Mr. Rea said that we could go on for five years at that scale of expenditure before the country would be in the position in which our grandfathers were at the close of the Napoleonic wars. But Mr. Holt replied that unless the right honourable gentleman was prepared to say that the war would be brought to a triumphant conclusion at the end of five years, the comparison was not a fair one. There were very few who took any such long-sighted view as this.

A week elapsed before the budget resolutions were reported to the House, and during this period opposition to some of the proposals had hardened. The Prime Minister had stated that all the tariff duties were to be considered practically as one proposal; that the Cabinet had weighed and considered them, given their ripe judgement of them, and submitted them to the House practically as one definite proposal. The Chancellor soon found himself, however, compelled to drop the tax on hats, and in the discussions on the tax on plate glass it appeared that this trade was in the hands of one monopolist in this country, and even that manufacturer was not in favour of a duty. Arguments about the

probable price of plate glass in the event of extensive damage through air raids were distinctly topical, and the Chancellor, being again careful to state that he was considering only business objections and not objections of tariff principle, consented to drop the proposal.

The income-tax resolution brought a miscellaneous discussion upon the points that were of paramount interest at that time, viz. the taxation of army officers, the taxation of co-operative societies, the exemption of charities, larger allowances for children and dependants, the charge upon wood-land, and the co-ordination of income-tax law and a general inquiry into anomalies.

The excess profits duty resolution brought out a curious plea from a shipping representative, Mr. Houston, for the special consideration of shipping. He pleaded that people abroad were subjected to no taxation such as would fall upon the British shipowner, with the result that they would have capital at the end of the war to employ in new tonnage, whereas the British shipowner would have none, with very disastrous results to the British mercantile marine. One would have thought that he was making a disinterested plea for the State advantage, and not something that would be to the good of the pocket of individuals.

Members still hankered after the taxation of 'excess incomes' rather than of 'excess profits', or else harked back to the war profit idea, dividing up the people who had made excess profits into various classes. As Mr. McKenna said, 'they desired to charge the "culprit" 100 per cent. on his excess profit; the "lucky" man would be charged 50 per cent., but the enterprising trader would apparently be treated on some specially favourable basis, a differentiation according to moral qualities.' At this stage the Chancellor began to indicate the kind of consideration that would be given by the special tribunal to such a case as a rubber plantation where there was a deferment of all yield for some five years at the beginning of planting. The members began to show their disposition to regard the tribunal as a special body to deal with all kinds of anomalies and hard cases. Fears were expressed that the duty would have the effect of depriving London of its position as a financial centre, if the tax were chargeable in

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cases where only actual residence and direction were found to exist here. It was clear that considerable opposition would be forthcoming to the charge upon trading periods prior to the outbreak of war, and apprehensions were expressed that difficulties would arise where companies had already declared dividends and divided the profits for those periods that had gone by, and yet were now to be specially charged. Members were being 'beaten up' by their constituents with concrete cases of difficulty, and the Chancellor found himself obliged to ask the members not to anticipate matters but to wait until the Bill itself was published.

About a fortnight later came the important debate on second reading. This debate suffered somewhat in quality from the fact that the Bill had been in the hands of the members for only a few hours, so that many of their remarks were misdirected, and difficulties could easily have been explained by a longer study of the Bill. The subject to which most attention was given was, perhaps, the tariff, more often called the McKenna tariff, which one suggested would become as famous as the McKinley tariff, and prove to be as futile, if not as dangerous to the interests of the country on whose behalf it has been introduced. The line of inducement to the Chancellor was: 'there were only six taxes originally; two you have taken away entirely, and you have reduced the largest and most productive by a half. Why not go the whole way and take them all off, and so save yourself all the endless difficulties that we foresee?' At first the duties were attacked separately on detailed and particular grounds, and the usual allegations of special interest were of course prominent. A powerful syndicated paper, it was said, had been carrying on a tremendous agitation about putting a duty on films on the ground that it would be a protective duty, and it was most desirable to protect the British industry against films made in Germany. This paper made no suggestion of discouraging luxury. One of the directors of a company owning this newspaper was said to be interested in film manufacture. It was alleged also that motor-cars were to be taxed 'because of a certain motor-car which is imported into this country from America, with which, at the present time, English motor-car

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manufacturers are not able to compete, and consequently British manufacturers require protection against that import until the time comes when they will be able once more to compete with it. This is the price we are paying for a Coalition Government.' Sir Alfred Mond said: 'I can go and buy a £1,000 motor-car, but if I want to substitute for it a much cheaper car, then I am to be taxed for doing so. If you wish to buy a Ford you have to pay for doing so, while you can continue to buy the big car.' He went on 'are we not already experiencing all that evil of evils, of Lobbying, of this setting up of private vested interests? . . . I have been more worried and bothered and so have other Members, by going into details of half a dozen trades, than during many previous years in the House'. Another speaker welcomed this very feature when he said that it opened a way for new principles to be enunciated by Chancellors in the future. He had a programme of an Empire Tariff of a scientific character, such as an export duty of £4 per ton on jute exported to foreign countries, and also an export duty on Canadian nickel. Others laid stress upon the moral effect of this tariff discussion: 'one set of people claim a triumph of our principles, and another set of people say, if they are violent, that they have been betrayed; if they are pensive they say they are bitterly disappointed. Who wants peoples' party principles to triumph, or be betrayed, or have any other emotional state attached to them? If this clause is kept in the Bill nothing can prevent this diversion of interests amongst the thousands of our fellow countrymen, and the consequent injury to that national unity which we all want.' On a verbal quibble as to whether this measure constituted Tariff Reform, one member said 'this clause does reform tariff, it resurrects tariff, it revives tariff, and therefore, it is tariff reform. . . . It approximates to Tariff Reform inasmuch as it contains no excise duties'. Sir Alfred Mond pointed to the loss on our re-export trade, e.g. parts of wrist-watches. Sir Alfred Mond was, perhaps, the most cogent speaker against the duties. He said that there was no tariff system in the world that had not been born during a war, and in regard to which the same argument had not been used as that offered by the Chancellor. 'I am as certain as I am standing in this box that if you pass these taxes

they will never come off'.¹ He pointed to American experience and showed that the taxes put on during the Civil War remained to that day. Mr. McKenna confined himself in reply to a statement that he could not understand how any member could think that this budget was either a Free Trade or a Protectionist budget—it was a war budget, devised to meet the particular conditions of the war. His Free-Trade principles were not to him moral principles. He could well conceive conditions, and did conceive them then, in which Free Trade, though still, in his judgement, the right policy in ordinary circumstances, might not be the right policy for the special year of the war in which they were engaged. If it was alleged that this was a Protectionist budget, all he could say was that the Protectionists ought to be ashamed of their protection. He could not conceive of any Protectionist producing such a budget as this, as an example of what he thought ought to be done in the way of protection.

Actual opponents of the excess profits duty were not numerous. One or two claimed that if one measured the effect of excess profits upon individuals and took into account the losses they had in other directions, there was no room for such a tax, and indeed there was a repetition of the claim for a tax upon increased income, i.e. upon individuals instead of upon businesses. The exemption of professions was criticized, and the Government were taunted with exempting their own class of lawyers and professional men. It was claimed that special treatment should be given to those cases where the Government were receiving large numbers of a particular article at a very low price, and where the firms had cancelled their other contracts. American competitors were said to be putting aside enormous sums of money as a fighting sum, and the chances were that at the end of the war they would crush the British companies out of existence. Only one or two members hankered after the war profits, but one claimed that the tax as framed would be a deterrent to enterprise, would drive business out of the country, would drive the registration of undertakings out of England, would do irreparable injury to London as the centre of the financial enterprise of the world, and he begged the Chancellor to pause before

¹ The 'McKenna duties' are still in existence, 1931.

insisting upon carrying a principle so far, as it had nothing to do with the war. To this speaker it was a most 'astoundingly awful budget'.

Sir Arthur Markham, who was throughout the debate one of the most powerful champions of the Chancellor's scheme, and showed a most disinterested spirit, said he could not conceive any tax more fair or more just in its operation. He said quite honestly that he was prepared to live on £1 a week and break stones on the road, rather than that we should not wage this war and bring it to a successful conclusion. He listened with amazement to a debate of this character. Everybody professed to be quite willing to pay taxation, but when it came to the actual application of the taxes everybody started to criticize. All the people he met said they were willing to make almost any sacrifice, but the moment one started to apply a tax they began to quarrel with the method put forward: 'I wonder whether honourable members really recognize we are engaged in this life and death struggle . . . the greatest war in the history of the world.' He went so far as to advocate, and at a very early stage, that the whole excess profits due to the war should be taken by the State.

This was the first intervention of Sir Arthur upon a subject which was destined to be one of the last in which he would take a lively interest. He felt the war burden very keenly, and he took most seriously the extent to which every man should make sacrifices and deny himself. No glimpse of those days is complete without a sight of his tall angular figure, turning every way as he stood denouncing with bitter scorn all who whined at taxation or tried to whittle away the provisions before the House. His fierce advocacy of the Government proposals was sometimes almost embarrassing to the Ministers themselves, and with his personal gibes at well-known members he lashed the House into excitement more quickly than any other speaker of the time. He was personally well aware that the heart affection from which he suffered, and which eventually brought him down with tragic suddenness during debate, might attack him at any time, but he was tireless in his zeal for the heavy taxation of the profiteer, and highly personal in his aims. 'If only I can make old —— pay

up all he's got I don't mind how much I pay' was his constant exclamation to the writer.

The debate was remarkable for a speech by Mr. Montagu, which had, perhaps, a more far-reaching and striking effect on the public mind than any other ministerial utterance during the budget debates of the whole war. He said that the budget had been accepted by everybody because it was framed to meet and fight Prussian militarism. For if it had not been, it would have been hailed from one end of the country to the other as the 'most disastrous piece of financial frightfulness that had been proposed in this or any other country'. He yielded to no one in his devotion to the principles of Free Trade, but he based the principle upon what he considered to be practicable considerations and it would be an act of grossest injustice to test the theory of Free Trade or the theory of Tariff Reform by the present conditions. In answer to Mr. Snowden as to whether the principle of the budget was to obtain no more for taxation than to pay the interest upon the debt that was being incurred, he said that it was neither their intention nor the result of what they had done. In round figures, the result of the new taxation of the war up to date would be £166 millions as a total yield in a full year, as against £78½ millions for the interest on new debt. He denied the imputation that the excess profits duty suggested the existence of a number of bloated felons in the country. It was not a penal tax, and was not intended to be. It was entirely a question of the enjoyment of extra profit during a time of general misfortune. To the members who had asked that the taxes should be transferred to the income tax, because that tax applied equally all round, Mr. Montagu replied: 'That is just what is wrong with the income tax, that it does apply equally all round. We want something that will apply only to those who are in the position of having what I may describe as income which they have not learned to live up to. When you get to a man whose income has suddenly grown very substantially over the income which he had last year, then he is not only the fit, but the appropriate person, to go to to ask for a still larger and very substantial grant.' Mr. Montagu showed that the alteration in the plan of the pre-war standard, giving a choice of two years out

of three, would meet many of the special cases, such as the Dublin strike, that had been put forward as a hardship. On the suggestion that the new tribunal would have very wide powers to deal with cases of hardship, he took the view that to give that tribunal, wherever it could be avoided, the decision of the individual cases, would be a grave mistake. He drew attention to a new provision repealing the tax on certain articles in which spirit was used for manufacture of medicine or things that were associated with doctoring and surgery—a concession appropriate to the conditions of the day. A second matter was a provision for preventing forestalments during the war. Whatever might be said about the practice of forestalling prospective taxes in times of peace—a procedure which enabled the trader to get enhanced profits out of the consumer at the cost of the revenue—it could not be tolerated in time of war. Then came his famous declaration that found its way immediately into headlines and upon placards, and startled the country at once into a sense of what was wanted—an almost indignant sense—in a way that had not been known before. He declared dramatically that everybody should be prepared to put to the service of the State one-half of his current income, either in the form of tax or of loan.

He gave one of the earlier clear enunciations of what Sir Basil Blackett later called ‘the gospel of goods and services’.¹

Mr. Tim Healy described this speech as one of the greatest he had heard in the House since the war began. It was in this debate that the proposal for a capital levy clearly emerged. Mr. Philip Snowden joined in the universal testimony and tribute to the sacrifice of life which both the middle and aristocratic classes had made, but said that in the matter of wealth they were not paying their fair share to the cost of the war.

Reducing the estimate of the pre-war national wealth of £15,000 millions to £10,000 millions on the strength of recent investigations, he said that the classes who owned the greater part of this capital were not paying their proportionate share. Under normal conditions he did not think a tax on capital desirable, but in abnormal times whatever objections there might be to such a tax on capital were infinitesimal compared with the ruinous

¹ Quoted from Hansard 1331–5.

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policy which the Government was pursuing of meeting the cost of war by loans. He proposed to exempt people with £1,000, and then beginning at 1 per cent. and grading progressively upwards.

Mr. Philip Snowden urged that we were relying to far too great an extent upon borrowing, and if our policy were to be to raise by taxation only sufficient to pay the interest upon the debt, then he looked with dismay at the financial situation of the country after the war. It would make economic reconstruction when peace returned an almost impossible thing to accomplish. In an historical retrospect he said that Pitt had financed the Napoleonic wars by raising half the cost by loan and the other half by taxation, and taxation at that time reached a sum which was equal to two-sevenths of the then National Income. During the Crimean War it was clear that the policy of Pitt had also been followed. Dealing with what he described as the fall in the credit of the country, he took the case of a person who invested £10,000 in Government Stocks, and stated that he would be £67 a year better off, after allowing for the increased income tax, than before the war. The only people in the community who benefited by the Government's policy were those who had money to lend. It would be disastrous for business men and for wage-earners, and he thought an impossible situation would arise in connexion with house rents. He was always a powerful advocate of the income tax, in fact if he had his way he would abolish every other form of taxation and raise the whole of the necessary revenue by means of income tax, with two reservations, estate duties and taxes upon alcoholic liquors, and possibly tobacco. He criticized very severely the attempt to raise more income tax from the lower incomes, and thought that those whose income was between £120 and about £150 should pay a small tax of 10s. and those between £150 and £180 should pay £1; those between £180 and £200 should pay 30s. There was much discussion of this subject of small incomes, the typical case taken being that of £200 a year. It cannot be said that this class itself was particularly vocal, but such a letter as the following certainly did typify whatever protest there was:

‘If the Chancellor will tax the man with a large income as he is taxing us, he might roll in money and pay his way. But no, the rich must be

spared whoever suffers. What sacrifice does the £5,000 a year man make when he pays £975? None at all. It is no sacrifice to give up superfluities. The sacrifice begins when the ordinary comforts of life have to be surrendered, the children's holidays stopped, part of their education perhaps, and when coal and even clothing and food have to be curtailed.'

The growing advocacy by many of compulsory service was linked up with this question. Mr. Dillon said that he found a formula being confidently put forward, but 'if you want compulsorily to take the blood of the people you must take their money first. Let the rich first be deprived of their money, and then we will consider the question of giving our lives.' Mr. Healy said it was 'not merely a question of paying the money, this infernal system of returns goes to the heart of the people, and has put upon poor men, many of them illiterate, the continual harassing of these forms, which is adding a burden to life wholly unnecessary'.

Mr. Montagu's striking appeal for economy by the people called forth a series of protests against Government waste. 'How can you ask a private citizen to economize when on all hands throughout the country you see the monumental government waste going on?' The system of giving a percentage of profits upon the labour employed and the materials used gave no inducement to economy to the contractors, but rather the reverse. One member quoted cases where manufacturers were getting, from outside buyers, articles that cost 15s. each and then selling the same article to the Government for £3 10s.

Sir Joseph Walton said 'the waste of food in connexion with camps is, in many cases, a perfect scandal. The price paid to army contractors is, in many cases, excessive'. He knew of one camp where they were able to buy potatoes locally of better quality at £2 per ton less than the army contractor was charging for them. He claimed that the Departments were overstaffed with thousands of new employees, particularly girl clerks, whose employment was very intermittent. The Chancellor replied of course that he was prepared to accept responsibility for the civil departments, but most of the expenditure was by the great war departments, and on behalf of the Treasury he had to repudiate responsibility. 'All history shows that it is absolutely impossible

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to hold up a department in its conduct of the great business of a war, while inquiries are made by another and independent department as to whether particular items of expenditure are needed. When total expenditure amounts to a figure approaching £5 millions daily, the actual percentage of the whole that is wasted through extravagant expenditure is extremely small, I am perfectly certain that it is not a heavy amount.'

The proposal to change the method of charging bank deposit interest to income tax met with considerable opposition by the banking interest, the main ground being that there were such a large number of cases where the amount to be deducted would be reclaimed, and there would be general discouragement to this most useful form of investment. At a meeting of bankers on the day of the second reading it was calculated that there might be something like 3,000,000 claims made for repayment.

The protest against further taxation of tea raised only the conventional rejoinders, with the customary comparison with cocoa and the usual allusion to 'Press' interests. One member proposed to put a tax upon proprietary names to houses. He said 'surely if vanity and luxury are fitting subjects for taxation, what could be more vain and luxurious than dating letters from "Sandringham" or "Chatsworth" instead of being content to do so from, say, 1 Grosvenor Square, or 1 Mile End Road'. He claimed that there was a great deal of money in this suggestion.

The subject of co-operative societies was only just touched upon. Mr. McKenna said that he had been in communication with the bankers, whom he thought had concurred with his proposal about bank deposit interest, and he hoped to settle the matter in a way satisfactory to them. There was one appeal on the question of the sacrifices by officers upon the lines that they were bearing more than their fair share, and yet the Government were imposing an additional burden upon them and upon a very meagre pay which was given. It was worse than ungenerous, it was unfair, to say to the men upon whom we relied to fight our battles: 'you shall not only bear the burden you are bearing, but you shall finally bear an equal financial burden with the men who stayed at home, who do not do anything for the country,

but try to make what profit they can out of the war.' Particular points were made of the cases where men had given up their businesses, which, however, were still kept going, and where the three years' average created an excessive burden. On the whole the debate was on a fairly high level, but it showed that the generous temperatures of the budget reception were beginning to fall.

But in the country generally Mr. Montagu had got well home, and the question 'Have you seen about giving half your income?' for a week or two rivalled the thrills of the subterranean news of the latest air-raid.

It would be tedious to take the reader through the long and complicated discussions in the Committee stage. They can more suitably be incorporated, so far as they were not ephemeral, explanatory, and clearing up misconception, in a later chapter dealing with specific taxes as a whole.

It will suffice if some of the leading lines of these debates, which were central to the whole scheme of war taxation, are here recorded, in order to reveal or illustrate the temper in which Parliament faced the issues involved. These Committee discussions are the more revealing of its true spirit than the generalities of open debate because it is in the details that protestations of heroism are put to the test.

In my position of vantage in the little official gallery behind the Speaker's chair, I heard, each evening, the impersonal and abstract representation of many concrete cases with which I was personally dealing in the course of the administration, and I had many glimpses of true disinterestedness! Moreover, established in the Chancellor's room each day to see members about their proposed or tabled amendments, I reached the inwardness of most of them in their personal aspects, and am bound to say that, with a few exceptions, spirit and motive were a credit to probity and patriotism.

The Committee stage of the excess profits duty was chiefly distinguished by the debate upon the nature of the profits to be taxed. There was a determined attempt to get the 'war profits' idea introduced, and to confine the charge to profits from businesses engaged in the manufacture or provision of materials of

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war. But the general sense of the House was against this, because it was known that it would let off many who, in public feeling, ought to be charged. More sustained, and indeed heated, was the debate about the charge on the first 'accounting period', which included some months prior to the outbreak of war. One accountant claimed that it would be quite easy to divide such business accounts on a basis of turnover. The Government, of course, said that it would really destroy the tax if business men were given an opportunity to make up their accounts over again, and it was alleged to be common knowledge that experts were giving advice all round the city to business men how to make up their balance sheets in view of the excess profits duty. The Government stated that to adopt the principle of charging nothing for the portion prior to the outbreak of war would mean a loss of £20 millions to the Exchequer. Eventually on a division the Government had 189 supporters against 28. Their intention had first been to fix the 1st September as the decisive date, but it was suggested by one member that the 4th August should be substituted, and this was accepted. There were the usual pessimistic cries about driving capital abroad, with particular reference to the Argentine Railways with their head offices in England. One shipowner prophesied that at the end of the war the centre of finance, of commerce, and of trade would have been transferred to America. It was quite noteworthy that when the debate had, so to speak, far advanced upon a particular line of criticism, somebody would pull them all up with the reminder that the money must be found, and that they were in the midst of a great war. One member exclaimed: 'it is a miserable sight to see this House cavilling at the introduction of taxes, complaining and trying to get a little bit off when thousands of lives are being lost every day'. Although this type of argument was sometimes indignantly received, nevertheless, it had its effect when it came to the question of embarrassing the Government in the division lobby.

In *Punch*, Toby, M.P., remarked that the procedure on the Bill in Committee was marked by incidents long unfamiliar, of divisions, in no fewer than three cases with a minority numbering twenty, twenty-six, and thirty-six, but he was sarcastic about

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the way the members left the House as soon as real business had to be done.

The exemption of agriculture in the United Kingdom was debated with some vigour, but it was agreed that the grounds put forward by the Government were sound. The first was that the farmer had already had an enormous increase in taxation through the raising of the Income Tax Schedule B threefold: by the increase in the rates of duty, and the fact that his abatements on the increase in assessment were smaller. For example, on a rental of £720 the previous charge had been on £240 less £160, or £80 net at 9*d.* or £3 duty, whereas now it would be on £720, with no abatement, at the rate of over 1*s.* 9*d.* or £63 in duty. The second reason was that as farmers in general kept no accounts, it was almost impracticable to start making assessments to excess profits duty, inasmuch as no proper computation of the excess would be available. There was some difference of opinion as to whether at that date farmers were making very high profits, but it was argued that it was illogical to be urging them in every way to put more land under cultivation and increase the food-supply, and at the same time render them liable to special taxation if they did so. After-experience proved that any attempt to have charged husbandry would have failed completely, but all the same there was some discontent later at the escape from duty of notorious cases of enormous profits from potato cultivation or other specialized production which was covered by the wide scope given to the term 'husbandry'.

In the debate on the exemption of professions, the Government's first proposal was to omit any 'profession the profits of which are dependent mainly on the personal qualifications of the person by whom the profession is carried on, and in which no capital expenditure is required or only capital expenditure of a comparatively small amount'. This gave rise to vigorous debates.

The first and greatest objection was that there should be no exemptions or exceptions to this charge on profits whatever, and that any one who was doing better than before the war or who 'had a better job, like some new cabinet ministers', ought to be within the scope of the charge. The second ground of objection

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was the ambiguity of definitions and the difficulty of distinguishing properly between professions and classes of employment or business in which small capital was used, such as that of a merchant, trading entirely upon borrowed money. The first line of the Government's defence of the exemption was that professions could not be brought properly within the scope of the Act, because it was impossible to find a suitable datum-line that would fit their case. To the rejoinder that professions should be asked to return their pre-war profits, and to pay duty on the excess, Mr. McKenna replied that all businesses had an alternative datum-line if they had not had satisfactory profits, and that datum-line consisted of notional interest on capital. No such alternative was available in the case of professions. His second line was that the professional man, if he were making any kind of excess profits, could only be doing so by greatly increased expenditure of energy and brain power, and was not in the same position as a merchant, who, though not having any capital, might be making excess profits because of mere increases in price. The next ground of resistance to the feeling of the House was that there would be no reasonable return to the Exchequer, as very few of the professional classes would come within the charge. On a division the Government had 107 supporters against 20 in the Opposition lobby, but the debate continued in substance upon another amendment on the same subject after the division. Mr. McKenna said:

‘If it were simply a case of saying anybody who is enjoying more profits during the war than he did before the war, the argument would be answerable, but it is not that; we have allowed in the Bill alternatives in the case of all businesses. You have to determine what a person enjoyed before the war, and we have taken as our arbitrary line, not what they actually enjoyed but the best two out of three preceding years, and if that does not give them a sufficiently favourable datum line, we may say: you may take as a minimum, six per cent. on the capital employed in the business, and if that is not a sufficiently favourable line and your business is of a special kind you may go to a Board of Referees, who may give you a higher rate of interest. My difficulty when I get to the professional classes is that I cannot take any corresponding arbitrary datum line.’

The debate was brought to a close in a rather curious way: a

member ventured to suggest 'that between now and a later stage the Chancellor should consider seriously the position in which he will find himself if he allows these exemptions to be retained in the Bill in their present form', and Mr. McKenna replied: 'I will gladly do what my Right Honourable Friend suggests; I did intend to use the term profession in its ordinary technical sense—an accountant would be included, but there may be some difficulty, and I will, between now and the report stage, re-examine these words with a view to limiting the exemptions as far as possible, but I do not wish to limit them beyond the scope of my own arguments.' Some undoubtedly thought that the Government were reconsidering the whole question of the exemption of professions between the Committee stage and the Report stage, but on the Report stage the Government moved to alter the opening words to 'the profession of a barrister, solicitor, doctor, architect, accountant and any other profession unconnected with the purchase or sale of property or commodities of any description', the change being 'declaratory and explanatory' only. The words were put in because of the overwhelming sense of the Committee in favour of a definite statement as to the meaning of the words. When the House found that they were not in a position to discuss the principle of the exemption at this stage, but only to accept something that did not add to the actual meaning of the statute, they dropped the whole subject, and the Chancellor withdrew the amendment, so that the original proposal stood.

There was a division also upon a motion to exclude any business carried on in the Colonies or Dominions or in India which was subjected to an excess profits tax in those countries. The Government thought they were doing sufficient in assuring the House that any duty paid abroad would, like income tax, be a deduction from profits. But of course, this was not in itself any avoidance of double taxation—it was merely avoiding a tax upon a tax—it still left as a plain fact that there would be two taxes side by side upon the same block of profits, but it was promised that this difficulty would be considered by the Report stage. There was a second division upon the subject of the exclusion of professions from the Bill with many caustic refer-

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ences to lawyers and cabinet ministers escaping their obligations, and it cannot be said that at any time during the lifetime of the duty the exemption of professions was wholly recognized as equitable. The accountancy profession, for example, which made so much money out of the excess profits duty itself, was free from charge, and this was a common grievance with business men.

There was considerable discussion upon the pre-war standard in its various aspects, such as an attempt to get a choice of one year instead of two years out of three, and it was in the course of this debate that the discovery was first really made which was to prove so true in the actual application of the duty, that it was largely a tax upon the less fortunate firms, or at any rate as much a tax upon them as upon those who were fortunate during the war. For, of course, the excess profits duty drawn by two businesses in other respects parallel, i.e. with similar capital and similar profits during war-time, would be widely different if one had a low pre-war standard compared with the other, and in this sense it was a tax upon the unfortunate. It was stated that the power to omit one unfortunate year was not enough, e.g. Mr. Redmond referred to the strike in Dublin in 1911, in 1912 they were engaged in getting over it, and there was another strike in 1913, so that all of these years were bad years; to which the Government replied that Dublin would be able to come up as a class or sub-class of case to the Board of Referees for special treatment. This, of course, never in fact happened, and it is a little difficult to see how such an application could have been formulated. But the Government's announcement of what was known as an 'abnormal depression' standard helped to relieve the situation, for it dealt with the case where the immediate pre-war years had all been bad, and enabled a business to take four years out of the last six pre-war years as its standard, provided that the second portion of the six years was substantially worse than the first. A business that had been doing badly over the whole of the six pre-war years could hardly be described as abnormally depressed, and it would be much fairer to regard it as a dying business. The special cases of developing companies, and companies like rubber, in which there was no possibility of

getting the full yield at first, were easily referable under the special provisions before the Board of Referees. Mr. McKenna at that time contemplated a class coming separately to the Board of Referees, such as 'rubber companies of six years standing'. But by this time he was alive to the dangers of permitting individual applications to the Board of Referees, and strenuously resisted all suggestions that led in that direction. He was equally adamant against attempts to raise the pre-war percentage standard above 6 per cent. Some had suggested 8 and others 10 per cent. but their arguments were largely irrelevant, for they were based either upon the general profits of the industry, which of course was not in point for a special alternative protective standard, or else they dealt with the state of the money market at the time when the Bill was being discussed, rather than with the conditions of the pre-war period.

Although occasional divisions were taken on such subjects they were usually in very feeble numbers against the Government. There was a very considerable distaste for going into the lobby against the Government, for it was an action that might possibly be construed as unpatriotic, and the fashion of the day was to be an out-and-out supporter of the excess profits duty as a true patriot.

During early informal discussion, the Chancellor had been made aware of special circumstances not confined to a particular business, to which consideration ought to be given in every individual case where they were found, but which it was impossible to legislate for in precise terms beforehand. These were put all into one clause dealing with the calculation of profits, and this clause was made the battleground upon which the whole measure, that is so far as administrative practicability was concerned, might have been wrecked. He provided for a change in the constitution of partnership, or the postponement, in consequence of the war, of renewals and repairs, and also for exceptional depreciation or obsolescence of assets due to the war. Various classes of cases were brought forward, and Mr. McKenna was able to show that they either related to one of the pre-war years, and such accidents could be avoided in the selection of years for the datum-line, or else they characterized a whole class of business,

and could be dealt with by way of an alteration in the statutory percentage. Member after member urged that this was the safety-valve which would prevent the whole scheme, so to speak, from exploding in difficulties and hardships, and therefore they set out to provide in general terms for exceptional cases. Some were content to leave this to the Inland Revenue, but the Chancellor said it would practically make them a taxing authority, with powers that should be confined to Parliament and not transferred. The whole debate on this issue really raised this constitutional question. The setting aside of shipbuilding, special 'dead work' in collieries, delay in driving on past coal faults, speculation by officials, the prohibition of the fulfilment of contract—were all brought forward specifically, but on the whole the plea was for words of the widest character. The whole debate was a 'long series of individual cases of hardship produced from all quarters of the House'. Sir Leslie Scott asked: 'What did that mean?' It meant simply that although the Bill was drawn very well, most carefully thought out, and though the Government had had the very best possible advice, although they consulted the business world to a great extent, there were a vast number of individual cases of hardship which were not foreseen at all by the Government. Could it be supposed for a moment that they had discovered every case? They knew there must be ten cases in practice to every single one they had foreseen in theory. He asked for the same kind of powers as had been given under the Munitions Act to the Minister, who could make 'appropriate adjustments' under a very great number of headings. He thought that the Act could not possibly work without something of this character, although it had been drawn with extraordinary skill and care. Mr. McKenna expressed himself as ready to accept any specific words applied to a specific reason which could be anticipated or foreseen and not properly dealt with elsewhere, but he objected to all general words which no man living could himself, in proposing the general words, associate with any definite case. They brought up in evidence against him words that he had used earlier in the House: 'of course if there are any special circumstances in cases of individual firms, we shall be quite reasonable, and such cases will be dealt with

by the tribunal which we are proposing to set up'. But the Chancellor had got out of tighter corners than this, and proved to his own satisfaction that he had fulfilled this pledge in allowing classes of business to come up for the percentage standard. When asked whether it would include one firm he said 'certainly, if the special circumstances belong only to one firm. Once a decision has been given in relation to these special circumstances, it will apply to all firms in which the special circumstances exist; that is the fulfilment of the pledge'. Again and again he urged that to hand over to any authority other than Parliament, or to anybody not responsible to Parliament, the power to state what was the amount to be brought under the tax, was to allow that independent body in substance to tax, and that ought not to be allowed. Eventually he proposed to add the words 'or any other special circumstances added by regulations made by the Treasury', and with one or two parting shots at the Treasury being under the tutelage of the Attorney-General this proposal was accepted. Only eight recalcitrants divided against the Government on the original amendment. Looking back over the administrative experience of the whole tax one can only conclude that the decision come to was wise in the extreme. At the time when the tax was imposed it was popular, popular even with those who were to come under it, because nearly every one treasured some special circumstances of his own that he thought would distinguish him from all other cases and materially lighten the burden. It was only when the slow disillusionment of facts gradually crept over the community that the early popularity of the tax began to wane. Just as every deputation to the Chancellor opened with an expression of approval of the objects for which the war was being fought, and support to the Chancellor in the great task of raising the money for it, and of particular adhesion to this form of tax, provided, as it was always added, that it was equitably administered and cases of hardship were properly provided for, so in the same way every interview at Somerset House opened with a profession by the taxpayer that he was heartily in favour of the excess profits duty, but of course, there were cases—exceptional cases like his own where the particular circumstances were pre-

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sent—where it would inflict grave hardship if the full burden were not mitigated. The taxpayer, as long as he could, hugged to himself the fond delusion that his case, above all, would be the one to be picked out for special ‘equitable’ treatment. As will be shown elsewhere, he plunged hard to get his cases taken to the Board of Referees to be dealt with, even if it were necessary to subdivide a class of business until his own case was the only one included in the subdivision! Any weakening by the Government upon the question as to when the tax should begin, or who should be included, or the rate of interest for the percentage standard, might have affected the yield of the tax adversely, but weakening in this matter of the individual appeal would have ruined it altogether, for the cases where the Inland Revenue Department would not agree to what the taxpayer imagined to be very hard in equity, would have been so numerous that the amicable relations existing for so long between the taxpayer and the Government Department would have been spoilt, and it was only by goodwill and generous dealing on disputed points that the tax was an administrative possibility. As it was, the provisions made in the Act and the elasticity given to them by the administrative officers far exceeded anything contained in the United States law.

Considerable anxiety was shown lest the Referees should tend to be an official body and the Government were urged continually to see that men with experience of trade and commerce were put upon it. Opinion was divided as to whether any particular case should be put before a panel containing at least one member who was himself engaged in the trade concerned. There was a clear idea too that the cases would be beyond the power and experience of the Board of Inland Revenue to handle, and that the Board of Referees should be an expert body who would arrive at decisions with greater ease and knowledge. Nothing that happened in subsequent experience actually bore out this view, for in nearly every case the Inland Revenue representatives put forward expert views or suggested the lines of settlement, and only rarely did the cross-examination by Referees, other than the Chairman, bring out material information that had not been secured by the official representatives. Doubtless the commer-

cial knowledge possessed by the Referees was exceedingly useful in confirming fair decisions, but there was nothing in the proceedings to indicate that they were really an expert body handling the matter in any technical sense. In general the Department provided much more expert knowledge. Great suspicion was shown lest a hidebound Board of Inland Revenue should, by stupidity or bureaucratic obstinacy and their 'interest' in the tax, prevent applicants from reaching the Board of Referees at all, and there was the utmost reluctance to giving the Commissioners any power at all. Only one member expressed the view that perhaps the tendency of the Board of Inland Revenue would be to send on too many cases rather than too few.

In the end the Department were given wider powers in the tax than had ever been allowed before, and the tax would have been unworkable without them, but they were not passed without criticism.

The clause conferring such powers enabled them to require details showing the profits of the trade or business during the accounting period of pre-war trade years, and such other particulars in connexion with the trade as the commissioners might require. It also added the significant words 'and the Commissioners shall have power also for that purpose to require any such person to allow them to examine and make copies of any books of account or other documents relating to the trade or business'. The debate on this subject was to outward appearances quiet, but three members spoke strongly opposing the grant of this new power to Somerset House, and Mr. Montagu, without beating about the bush, withdrew the words. There had, however, been a storm behind the scenes and it had been made clear by many members that they would oppose this proposition tooth and nail. Some of them to my knowledge had good personal reasons for so doing. Anybody engaged in the administration can say with confidence that the omission of these words and these powers must have cost the country hundreds of thousands of pounds. It was an extraordinary commentary upon human nature, at a time when men's liberties were being interfered with in every direction, when their businesses were being compulsorily controlled, when their commodities were

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being rationed or prohibited, and later when men were being sent to their death and the supreme possessions of life were at the mercy of the State, that the State should have taken no power to look at a trader's books!

There was much discussion upon the question of business reserves, and many amendments were put forward designed to allow the trader to apply to capital purposes such sums as corresponded to the practice of the business of the previous years or as were thought to be necessary. The phrase 'what a prudent trader would do' came to be almost a byword in official circles.

A writer in *The Times* had said that the proposal of the Government to appropriate one-half of the funds which would otherwise be put back into industrial enterprise, seemed almost analogous to appropriating one-half of the seed-corn necessary for the next harvest for the purpose of temporarily lowering the cost of the quartern loaf. After all, there was not much to be said beyond Mr. McKenna's caustic summary at one stage:

'If he exercised his natural discretion and did justice by the business for which he was responsible, he, the manager, would clearly devote one hundred per cent. of his excess profits to developing his business, and would thereby avoid paying any tax. I am afraid my honourable friend shows a childlike simplicity when he imagines that the taxpayer would voluntarily surrender fifty per cent. of excess profits, instead of reserving the whole one hundred per cent. for the benefit of the business during the war, and then after the war dividing that excess profit in the form of bonus shares. I am afraid the proposal of my honourable friend is an ideal proposal, but in this wicked world we must consent to be taxed by compulsion and must not rely upon the voluntary system.'

This suggestion cropped up from time to time throughout the whole lifetime of the tax. It never got clearly home to the minds of these reformers that the putting of a regular sum to reserve was merely a *function* of the rate of tax, and that 50 per cent. of the whole profits was much the same thing as 55 per cent. of the whole profits after deducting 10 per cent. for reserve, and if the tax had been expressed in the last form very little complaint could have been raised. The device of allowing a regular percentage of profits for any such purposes of reserve, was merely a device for whittling down the nominal rate of the tax. But it was not peculiar to those days. Ten years later, in peace, the

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most strenuous efforts were made in evidence before the Colwyn Committee on Taxation and the National Debt to secure the principle of the differential taxation of reserves for income tax.

The immense activity of the time in the erection of new buildings and plant is reflected in the debate when much confused thinking and speaking related to depreciation and obsolescence, the 'writing off of values that would disappear at the end of the war', but under genial ministerial patience and explanation the discontent gradually faded away.

The last considerable debate on the Committee stage of the excess profits duty was upon the conception of capital contained in the Bill. There are so many different conceptions of capital in business that it is not at all surprising that the members for a time were at cross purposes. At one point Mr. Montagu protested 'all around us are technical advisers, men expert in business who are endeavouring to instruct, and who are instructing the amateurs on the Treasury Bench as to what the principles of valuing property ought to be, but they all differ from one another, and they all accuse one another of colossal ignorance. We have proceeded, being ignorant of the niceties of technical accountants, upon what we thought were the simple lines of valuing assets'. This was nicely modest on the part of Mr. Montagu, but it hardly reflected the careful thought that had been given to every possible alternative by the officials before the scheme was completed, and to whom, sitting with their little blinking lights in the gallery, the gropings of members after what had long been clear to them were not a little tedious. Some were thinking of the left-hand side of the balance sheet, others of the right-hand, others jumped in a disconcerting way from one to the other. There was much discussion upon the question of whether debentures should be regarded as capital, and members woke up to the fact that they had trapped themselves sometime previously by allowing debenture interest to be a deduction from profits, which necessitated as a logical consequence the deduction of the debentures themselves from the total value of the assets in the business. It was too late to go back, whereupon they got the Chancellor to promise that he would reconsider the whole

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question upon Report stage. The subject was a technical and forbidding one, and the House felt a little out of its depth.

The principle of the Mineral Rights Duty throws an interesting sidelight on taxation principles.

It was pointed out in the earliest debates that mineral royalty owners were receiving large sums through the special activities of the war, and whereas a colliery owner owning the freehold would bear the excess profits tax upon the royalty concealed in his profits, the ordinary royalty owner not in business himself would be exempt. The most obvious course would have been to charge the recipient upon any excess of his total royalties over and above his pre-war receipts. But this would have been really wrong in principle. If a cotton spinner made excess profit during the war years, that in no way impaired the ability of his business to earn profits in succeeding years to the same extent as it might have done had there been no war. But if a mineral was worked to a specially vigorous extent during the war years the mineral was gone for ever, and there was correspondingly less to be worked in later years. Although the war hurried the yield it did not increase it, and the only gain to the mineral owner in the long run was the much higher money rate at which the royalty might be payable per unit of quantity mined. For this reason excess profit was defined to be the amount produced only by the *extra price* upon the actual tonnage worked, and a mere increase in quantity without an increase in price led to no liability. In many coal areas the royalty did not increase with price, but for hematite ore and other minerals the yield was often substantial because the royalty moved on a sliding scale.

So far as the income tax was concerned most critics and defenders claimed to be supporters of the principle of equality of sacrifice, but whereas the Government claimed that their new scale was giving a fair spread of the burden upon different ranges of income, the critics looked rather at the *amount of tax* that was being added at this particular stage, and they thus rather took for granted that the original scale was satisfactory. The line of attack was that the man with £300 a year was having 40 per cent. added to his *tax*, whereas the man with £10,000 a year was

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having only 27 per cent. added, and it was stated that the Bill for the first time increased the burden enormously on those who were least able to pay, and graded it off steadily to less burdens as the higher incomes were reached. It was, therefore, said to be in principle an absolute reversal of the whole spirit of the Income Tax Act.

Mr. McKenna took up the challenge on the grounds offered, but did not deal with *additions* to the tax so much as the *actual amount* that the taxpayers would in future have to bear. The tax on the man with £200 a year who had no children was increased from 1s. 2d. in the pound to 1s. 11d., or, if he had one child, from 1s. to 1s. 8d., with two children from 10½d. to 1s. 5½d., and with three children from 10d. to 1s. 3d. in the pound. These figures related to unearned income. He said that under the new budget with the additional tax, this person was still the lowest-taxed man in the country. Dealing with earned income, he said that he would show how the Budget in fact conformed to the principles of equal tax sacrifice. The man with 30s. a week before the budget paid 1s. 3d. in the pound *total* taxes, and now it would be 1s. 9½d. The man with 40s. a week formerly paid 1s. 2d. and would now pay 1s. 8d. The man with 50s. formerly paid 1s. 1½d. and would now pay 1s. 6½d. as compared with the 1s. 8d. in the pound paid by the man with the smaller income. The man with 60s. a week who then came under the Income Tax ceased to pay 10½d. and would now pay 1s. 7½d. On the higher ranges, as against 1s. 11d. in the pound paid by the man with £4 a week and no children, the income of £300 would pay 1s. 8d. and £500 2s. 4½d. in the pound. On £1,000 the wholly earned income would pay 2s. 10d. and the wholly unearned 4s. 4d. in the pound. On incomes of £5,000 a year it ranged from 4s. 7d. to 4s. 9d., according to whether it was wholly earned or wholly unearned; and on incomes of £10,000 it ranged from 5s. 5½d. to 5s. 7d. These estimates included income tax, super tax, house duty, land tax, stamps, and indirect taxes, the taxes on motor-cars, in fact all taxation. His contention was that the man with £2 or 30s. per week was happier than the man with £200 a year who had been so freely quoted. The only question raised upon the increase of tax on farmers by the substitution of the whole rent for one-third as the

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test of income related to the treatment of woodland, for woodland kept for special amenity, and woodland kept for commercial purposes, with woodland kept for sporting, all seem to require different treatment.

Attempts made to get an increased allowance for children and to extend the allowance to adopted children and to get an increase in respect of wives were all successfully resisted.

The temper of the legislature was such that the passage of the Bill was secured without great opposition. The need for money was realized as serious, and the widespread feeling in favour of taking toll of the wealth which was accruing to many persons fortunate enough to stand in the direct line of the new demand, made it difficult for any member to raise his voice in opposition to the general principles. But a widespread interest was taken in business constituencies in the detailed application of the measure to particular cases, and most of the debates, when they ceased to be platitudinous, turned upon amendments raised by members who had particular cases in view, or who desired to increase the rates and amount of allowances so as to make the real weight of the duty less than its apparent weight. It is obvious that a rate of 'sixty per cent.' can be greatly altered in the extent of its severity without changing its nominal amount if profits are indulgently defined, or if all kinds of special allowances are brought into play with every individual circumstance. These special pleas, though often vigorously urged, never received considerable common support, as soon as the ministerial objections to them had been stated, and, especially when members were brought frankly into touch with official draughtsmen and exponents of the scheme, many potential amendments never actually cumbered the order paper at all. Taxation questions can seldom be simply expressed in an Act of Parliament if it is going to work satisfactorily, or at any rate not so simply that a legislator in a hurry can safely apply its provisions himself, and in this instance there was a novelty of arrangement in the statute which further baffled the first approach. For these reasons, the almost pedagogic domination which Mr. McKenna and Mr. Montagu seemed to exercise over the House, while to some extent due to the more general position of advantage

enjoyed by the Government in the crisis of war legislation, was also akin to the special advantage which is enjoyed by any preceptor who is himself several lessons ahead of his pupils in a new subject. Nevertheless, the whole subject was one well calculated to exhibit the Chancellor's particular powers of lucid exposition and handling of figures to the best advantage, while his great skill as a parliamentarian made him more than a match for freebooters in isolated guerrilla warfare, and both Ministers greatly enhanced their reputations during the passage of the Finance Act.

The third reading was taken on the 9th. December 1915. Sir Alfred Mond led off a long series of eulogies by different sections when he congratulated the Chancellor 'on having brought this highly complex and controversial measure' to this stage, and on the unfailing courtesy, tact, kindness, and patience with which he had 'piloted this difficult measure'—certainly the largest and most important Finance Bill ever introduced.

But the taxation was after all only a mere trifle compared with the enormous cost, and the Chancellor would 'probably regret in successive budgets that he has been so moderate in his demand, as no doubt his predecessors have done'.

He referred to the anomalous double taxation of munitions establishments. Others dealt with the obvious drawback of the excess profits duty standard and the breach into the Free Trade citadel. The doyen of the defenders of agriculture, begging that the new impost should not be renewed, made a survey of the woes of the farmer. Sir Arthur Markham, speaking with premonition of his end, rejoined: 'If I am in the land of the living and a Member of this House when the time comes for this question to be debated again, I shall certainly vote for the continuation of this tax.' On the excess profits tax he said: 'I am the only member—one out of 669 wise men and one fool—who has from the commencement of the war taken the view that the Government ought to have approached the question by stating at the commencement of the war that no one should make any profit out of the war.' He railed continually at the 50 per cent. rate as a vicious circle and at the way in which those who supported the tax in the abstract raised every objection to it in

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detail. In the chorus of praise Mr. McKenna found no necessity for any reply and his task was done. By the end of the month the regulations under the Act were tabled, and its administration was begun. The House sat on until the 27th January. Beyond a few stray questions, interest in taxation waned, though the Land group asked for conscription of wealth and estates to match the sacrifices in the field, and others suggested the excess profits duty principle should be applied to all individual incomes which exceeded the pre-war levels. But Parliament met again on the 15th February and Mr. Asquith in the debate on the address referred to the daily liability (which in the recent third reading had been regarded as £3½ millions) as £5 millions, and then foreshadowed that the Chancellor would soon have to make large additions to taxation—a statement that evoked no protest or fear but was welcomed by several speakers. There was a general lull in discussions upon taxation until the next Budget was introduced on the 4th April 1916—the only important interests aroused, of a dynamic character, being references to the remarkable profits being made by shipping, with advocates for special discriminating taxation in full cry.

2. April 1916 Budget.

On 4th April 1916, when the war had been in progress for two years and three-quarters, Mr. McKenna introduced the fourth war budget. He perforce assumed that the war would last throughout the ensuing financial year and asked for 'generous allowance' in the difficulty of forming correct estimates, both for necessary war expenditure and for the effect upon revenue of restrictions on imports.

The actual expenditure for the previous year was £1,559 millions, or £31 millions less than the estimate, a difference which was almost entirely due to the financial assistance given to the Allies being rather less than had been contemplated. The year's finance had been complicated by the purchase of American securities out of revenue and by building up from the proceeds of sales, so far as they were not already expended, a substantial asset in America with which to begin the current year.

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The estimate of revenue, £305 millions, was exceeded by £32 millions. £6 millions had been budgeted for from the excess profits duty, but owing to the late date at which the Finance Bill had passed through the House, its proceeds had hardly begun to flow into the Exchequer by the 31st March 1916. The difference between the total expenditure and total revenue was £1,222 millions, which had, of course, been made good by borrowing, and the total national debt then amounted to £2,140 millions.

The Chancellor laid down the principles which governed his policy:

‘The manner in which British credit has withstood the immense claims made upon it by the expenditure of this war is truly wonderful to those who are not familiar with our financial methods and resources, but when on examination, it appears that we never borrow a pound without making provision in advance by new taxation, sufficient to cover both interest and a liberal Sinking Fund, the foundations upon which alone national credit can be built are exposed to view.’

Looking forward to the coming year he estimated the gross expenditure at £1,825½ millions, or almost exactly £5 millions a day, but, after deducting the advances to the Allies and Dominions, it was £1,375 millions, or 3¾ millions a day, approximately the rate of expenditure of the various services at the moment of speaking. He anticipated that this large total would be reduced during the course of the year, for he regarded the ‘overwhelming pressure consequent upon the creation, under circumstances of extraordinary difficulty, of a vast new military organization’ as being over, and the country as ‘reaching the measure of its full expansion’. On the other hand, there had been a material rise in prices, and the result of the economy that could be effected might do no more than make up for the increased charge from this course, and he, therefore, took the expenditure for the whole year at the rate named above. The net revenue was estimated at £502 millions, of which £86 millions would come from excess profits duty and munitions levy, leaving the revenue from forestalments and the more permanent taxation at £423 millions. Deducting this from the total expenditure there was a deficit of £1,323 millions to be made good by borrowing, and taking the

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interest at 5 per cent. and the sinking fund at 1 per cent. the new charge thereon would be £79 millions.

The estimated revenue, excluding the excess profits duty of £423 millions, was £93 millions more than in the previous year, and the increase was thus far more than sufficient to cover the charge for interest and sinking fund on the new borrowing.

The chief additions to taxation were, first, income tax, where the normal or maximum rate was increased from 3*s.* 6*d.* to 5*s.* On the small earned income of £500 a year the rate was 2*s.* 3*d.* instead of 2*s.* 1½*d.* and in the next stage from £500 to £1,000 a year was 2*s.* 6*d.* instead of 2*s.* 1½*d.*, the rate of 5*s.* being reached on earned income where the total income was £2,500 a year. On unearned income the new scales gathered 3*s.* on incomes not exceeding £300, and rose by stages of 6*d.* up to 5*s.*, which was paid on all the incomes exceeding £2,000. This increase was estimated to yield £43½ millions. There was no corresponding increase in the super tax, for the obvious reason that the increases in the income tax fell most heavily upon the classes actually subject to super tax. People who received income from the Dominions, where the taxes were not less than 1*s.* 6*d.* in the pound, would not have any fresh burden imposed upon them.

The second heading was the amusement tax, estimated to bring in £5 millions. Then came a tax on railway tickets for journeys costing over 9*d.*, estimated to yield £3 millions, and an additional duty of a halfpenny per pound on sugar. The price of sugar at the time was about 2¾*d.* per lb. wholesale in bond, and in New York it was just under 3*d.*, so that despite freight, insurance and handling approximating to 1*d.* in the lb. it was still cheaper here than in America. The Chancellor said we could not continue to sell sugar at this cheap rate in comparison with the world's price, and was therefore proposing to add a halfpenny to the price, which they would take in the form of duty. This would yield £7 millions. Higher duties were proposed on cocoa, coffee, and chicory to raise £2 millions in a normal year, and a duty on matches of 4*d.* per thousand. Mineral waters were to be charged at the rate of 4*d.* per gallon for table waters prepared with sugar or fermented, and 8*d.* per gallon on all others, the revenue anticipated being £2 millions. Motor-cars and motor-cycles

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had been liable to a range of duty of from two guineas up to £42, with a uniform charge of £1 on motor-cycles. The duty on cars not exceeding 16 horse-power was proposed to be doubled and on the higher-powered cars trebled, the revenue being estimated at £800,000. The present new taxes were estimated to yield £65 millions, out of the whole extent of £93 millions, the balance coming from the new taxes which had been previously imposed, but which had been running for six months only. A reduced revenue was expected from beer and spirits, notwithstanding the increased duty of 1s. a barrel on beer, owing to diminished consumption. Mr. McKenna said that if there was an increase in price not warranted by the additional restrictions on the trade, he would feel it his duty to absorb such an increase for the benefit of the public by taxation. He proposed no fresh attempt to prevent the consumption of imported luxuries by means of duties, but preferred to rely upon the growing scheme of prohibition that was applied by the Board of Trade.

Under the excess profits duty the main alteration was to raise the rate from 50 to 60 per cent. on all accounting periods after the first twelve months. He pointed out that the effect of this increase, coupled with the full new charge for income tax and super tax, in the case of very rich persons, would mean a total burden of 77 per cent. out of the excess profits, and he did not think it would be safe to take a much larger proportion by way of taxation. He also proposed to prevent loss of duty by providing for taxing excess profits realized by the sale of 'profit-producing assets', which was a euphemism for ships. He said that after much anxious consideration the only way he could find of dealing with controlled establishments liable to munitions levy was to let the munitions levy be paid in so far as it did not exceed the excess profits duty, and be accepted in discharge of excess profits duty, but if the latter should be in excess of the levy the balance would have to be paid over. £86 millions was estimated to be collected during the year. He said: 'Those who are better informed than I am of the financial history of other countries may find a parallel to the willingness displayed by our citizens as a whole to submit to the exactions of the tax gatherer. I know of none. But it would be a mistake to drive this spirit of

public sacrifice too hard,' and concluded by eulogistic reference to the way in which our ability to bear the burden of taxation had established our national credit on an unshakable foundation.

The Budget Speech was persuasively delivered and easily followed. The chorus of appreciation was, perhaps, a trifle over emphatic for those qualities, for Mr. McKenna was invariably lucid. 'We have grown accustomed to his exceedingly clear and interesting way of stating financial facts, and he has lost none of our admiration'. From several it was 'bold and wonderful'—'an arduous duty never surpassed in the history of the country'. One sat 'amazed as the Chancellor drew from the submarine of his mentality'. Only Mr. Hewins found it 'a triumph of futility'. It was accepted with 'high spirits' and Mr. Montagu at once acknowledged the 'gratifying assent' to the proposals. The Chancellor was congratulated on not indulging in the 'wing-flapping' that was common in Germany. Although the budget was called 'extraordinarily courageous' a feeling began to find general expression that hitherto the Government had moved too slowly in taxation and had not acted early enough. 'Splendid speeches are futile . . . an ounce of practice is worth a ton of precept, and if the whole nation will follow the splendid example set by His Gracious Majesty . . . the financial difficulties will be met.' The general burden was discussed with many graphic and vivid touches. Mr. Barnes said that full estimates of expense were necessary so that they could know the worst. Certain types of editors went about 'killing Germany with the end of a pen' and feeding people with false hopes. It was continual disappointment and irritation that led to 'ginger groups' in the House. The principle of compulsion had been applied to the younger men and ought to be applied to the wealth of the country—incomes even of £10,000 were an anomaly, an outrage on the feelings of many. A man with £100,000 would still be left with £60,000, which was not equality of sacrifice.

The relief to war burdens by indemnities had begun to be talked about more frequently, mainly because the German Chancellor was boasting of a peace inflicting immense indemnities upon their enemies, making them contributory states to an all-powerful Germany. Sir Joseph Walton said he 'did not think,

however victorious we might be, we should get much relief in regard to our war expenditure by any indemnity from Germany after she had made good the actual devastation'. This was an additional plea for economy.

Some resentment was felt at 'waste' in expenditure by the Army, Navy, and Ministry of Munitions. The Chancellor had said he was utterly unable to supervise and control such expenditure, but it was urged that control must be resumed to the fullest extent. It was said that the Germans, with twice the forces, were incurring only two-thirds of our expenditure.

The proposal for a tax on railway tickets was received with such general hostility from the first that the Financial Secretary, as early as his summing up of the debate on the first evening, began to prepare the way for retreat. He averred that the tax would not be so heavy as to bring the disastrous consequences so many seemed to anticipate, but there would be ample opportunity to reflect before it became operative. It was opposed upon various grounds. It was inopportune, for people were not 'joy riding' at such a time. It was unfair to Ireland and to all long-distance travel in the kingdom; it was a bonus on foreign travel; it would put undue pressure on the poor and ought to be confined to first-class tickets; it reversed the policy of encouraging development of dwelling areas in country districts, and was reactionary and unhygienic—men working six days a week before heated furnaces ought to be encouraged to go to the seaside for fresh air; it was uneven in its effect upon working men living at different distances or with families; it was unprofitable and pettifoggery in relation to the great budget charges; it would lead to great agitation amongst workers and demands for increases of pay; free mileage ought to be extended to cover all the traffic of workmen going to their jobs; it was wrong in principle to hamper railways with fresh burdens at such a time and restriction of travel only reacted upon the Government at a time when they had assumed financial responsibility for railway results. It must involve similar taxes on travel in motor buses which were competitive and did so much road damage. Only one solitary voice was raised in mild defence on the general ground that every one must make sacrifices.

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Next in order of unpopularity was, perhaps, the proposed tax on matches. Zealous supporters of the Chancellor thought he should have hesitated to risk the fate of his predecessor, Sir Robert Lowe, in this matter. 'It has always been historically painful to me', said Mr. Lief Jones, 'that he was frightened out of his match tax by the procession . . . our nerves have become harder . . . in these days Mr. Lowe would not have been so easily frightened by people saying they were going to be unemployed.' Labour members urged that 'rich men switched on the light, but the poor were the real match users, for they rose early and fumbled with candles and lamps'. It was altogether a futile tax—an 'unworthy and reactionary tax'. Defenders said it would be mainly contributed by smokers, who could well bear it—too many matches were wasted, but it would soon 'pass into the limbo of forgotten things'. The fewer the matches, the less the lights, the greater the darkness, and therefore the worse for the Zeppelins.

First in popularity amongst suggestions pressed upon the Chancellor came a tax on advertisements, so frequently found abroad. It was urged that it would help to lessen a public nuisance and relieve the landscapes of horror. The financial Secretary said this industry was, at the moment, in a struggling condition, seriously hit by the war, and the imposition was impolitic. The mineral water duty was popular as a hit at the 'elusive teetotaler', but it was recognized that in fact the bulk of the duty would be paid by whisky consumers.

Among the further suggestions were a postage tax, put forward by a Labour leader. A tax on imported hops, designed, amongst other advantages, to reduce the demands upon available tonnage, was met by the Treasury Bench asserting that the best way to save tonnage was 'to grow bread and meat at home', and, therefore, the worst way was to 'encourage people to put more rich agricultural land under hops instead of putting it under the necessities of life'. The usual plea for a tax on co-operative societies was not lacking, especially where their profits were not derived from their own members, but from 'wider competition' and general contracts. The proposal to tax bicycles received little support. The inveterate land taxers made their usual case:

‘I do not see how building is ever to recuperate and houses to be put up in the way they ought to be owing to the Sch. A tax.’

Healy said the whole taxation of Ireland in the Napoleonic wars was only £1 million a year. Before the war they reached £10 millions and were now going to be raised to £27 millions, and Irishmen were not being enriched by the war. He complained of discrimination against Ireland in economies with no one to watch her interests. He feared the future and demanded a separate fiscal inquiry for Ireland.

The member for South Tyrone, however, said it was a disgraceful thing for Irishmen to come to Parliament and plead they were being imposed upon. Farmers in Ireland were having the time of their lives. Irishmen could come to England and snap up the jobs of Englishmen called to service. Mr. William O’Brien made a long speech challenging the application of the whole of the taxation to Ireland: ‘If there had never been a Home Rule movement, to my mind these War Budgets would make repeal of the Union in its present form an imperative necessity.’ The future of that country ‘is being fatally mortgaged by these tremendous liabilities’. Mr. McKenna said this was the only criticism which went to the root of the budget as a whole—a criticism not justified by the exceedingly prosperous state of Ireland and her ‘wholehearted sympathy for the cause’.

That a period of bad trade would follow the war was a deep conviction in not a few quarters, and this made the possibility, held out by the Chancellor, of a reduction in taxation at a relatively early date a rather weak one.

‘The chance of these loans being repaid is largely problematical’, was a remark striking at the heart of this hope. The fear of such financial exhaustion and bad trade as would weaken purchasing power completed the pessimists’ rejoinder. ‘To imagine that, when the war comes to an end, this revenue which has been swollen by excessive expenditure will go on, is to delude and mislead ourselves and the country as to the future revenue we are likely to receive.’ Mr. David Mason quoted the appalling estimates of a French financier that the war would cost all the nations of Europe £61,400 millions—we were approaching inevitable bankruptcy. ‘It is ludicrous to talk of this country

requires any person or any class of persons very materially to alter their accustomed standard of living.' Others said that direct taxation had now begun to affect the prices of goods.

The Sugar Commission came in for some criticism for 'going beyond its power' in reducing consumption and 'levying a secret tax' without proper authority, and moreover unequally.

Sir Arthur Markham said there were two vicious principles in the budget. The first was that of the recognition of excess profits. Others had said the Government had allowed the people to be exploited by over 3,000 controlled factories and then tried to 'get back on them' by a tax. The Government ought to have laid down a rule that no one was to make a profit out of the war. Rich men were certainly paying, by the super tax and income tax, all that could be expected, but the working classes were not paying according to their ability. The Chancellor ought to take a bold step and put a tax on wages as such, for the second vicious principle was that taxes were being put on the necessities of life consumed by the poorest section.

Men had begun to realize that serious problems of reconstruction must press upon the world the moment the war was over. There was talk of the necessity for a political truce, during which every school of theory and of practical experience would be mobilized to form, in the national emergency, a truly national policy.

Some, like Sir George Reid, thought of reconstruction in terms of Empire preference. Others said that we were straining one kind of finance too far, by too great an insistence upon one particular form of taxation, and there would be disaster to be faced by many firms when the war was over. It was estimated that the revenue to be raised after the war would be £300 millions per annum, or even probably £450 millions. The Paris Conference was claimed to be the most important economic consultation that had ever taken place in the modern world. Here and there came a complaint that too much was being raised by taxation. Mr. Hewins, taking up the Napoleonic comparison, said: 'we should have been bearing twice as large a burden so far as revenue is concerned as our ancestors did in that famous struggle if the Chancellor had left the taxes exactly where they were.' This statement was traversed. The proportion during the Napoleonic

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was put by one member at $27\frac{3}{4}$ per cent., nearly exactly the proportion the Chancellor had raised in the current year.

These budget discussions throw interesting sidelights on social conditions.

At this time there was much discussion about the prohibition policy of the President of the Board of Trade. It was dragged into the budget debate by those who thought that prohibition would be more successful if carried out by means of prohibitive duties.

There was also considerable comment upon the increase in the consumption of spirits. The total drink bill in the preceding year was £17 to £18 millions more than in the year 1914, and although much of this money had gone in taxes to the Government the fact remained that the country had spent that sum on drink, with results which gave the Government considerable anxiety. This was in marked contrast to other countries where there had been a substantial diminution of such consumption brought about by legislation.

A practice had sprung up for manufacturers of cheap jewellery to make their jewellery largely out of sovereigns. It was, under the law, an offence to deface a coin, but not an offence to destroy the coin altogether. Presenting a Bank of England Note for £100 enabled a jeweller to obtain one hundred sovereigns and, on melting them down with an alloy, turn out that cheap jewellery so attractive to the working classes with their improved wages. One of the trades booming at the moment was therefore that of cheap jewellery. This process saved the jeweller a great deal of trouble—he knew exactly, from experience, what his sovereigns weighed, what they were worth, and exactly how to treat them for the alloy. It was suggested that a tax should be put on jewellery in order to check this process, but the Government did not think it was properly a Revenue matter, and proposed to deal with it by way of a special prohibition.

Amongst other claims arising through the circumstances of the times were proposals to deduct subscriptions to hospitals and kindred institutions and more especially the Royal Patriotic Fund.

The outside reception of the new proposals was, of course, an outspoken one.

Punch's cartoon shows McKenna on horseback as 'Claude Duval' leaving the coach in which John Bull was seated smiling, 'a willing victim', and saying: 'This has indeed been a pleasant meeting—you are quite sure you've got all you want?'

Toby, M.P., again contrasted Mr. McKenna delivering a war budget with Mr. Gladstone giving a peace budget, the former taking seventy-five minutes and the latter four or five hours. 'After observing that there was no parallel in history to the willingness in fact which had been displayed by the British people, he declared that it would be a mistake to drive this spirit of public sacrifice too hard.' The difficulty which many people had in maintaining a standard of life suitable to their condition was described in such moving terms that it convinced some of Mr. McKenna's more ingenuous hearers that the income tax was not going to be raised after all.

A little later a provincial paper referred to Mr. McKenna as the 'Cancellor', 'a humorous compositor's way, no doubt, of indicating the modifications in the budget'. Hardly one of the proposed new taxes had survived intact. Even the tax on mineral waters had had to undergo considerable alteration. 'It was devised to get some contribution towards the Nation's needs from those who wear the blue ribbon of a beerless life', and to that end the tax was to be collected by means of a stamp on each individual bottle, but the manufacturers successfully protested that the boys and girls who affixed the labels already adorning these gaseous wares could not be trusted to put on stamps as well. Mr. Montagu announced that the manufacturers would be taxed direct on their certified output, but he did so with obvious reluctance, and so this, which was once a sparkling proposition, had become, said Toby, M.P., 'indubitably flat and possibly unprofitable'.

Between the 5th April and the 18th May nothing occurred in the House of Commons except the brief proceedings when the budget resolutions were reported.

On the second reading, much the most important subject discussed was that of 'premium bonds', in which acute differences of opinion, not following any party line, were very apparent. The subject lies outside the range of this volume, but it certainly

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served at the time to distract attention from many features of the budget relating to taxation which must otherwise have come in for further criticism. One of the reasons urged for the premium bonds was that the Chancellor had sunk his financial bore-hole right down to the strata of the commercial man. He had tapped that strata—he had not dried it up, but he had tapped it very severely, and the proper thing was for him then to sink that financial bore-hole deeper into another strata so as to touch the working classes and give them an opportunity of having their place in the country. These people did not ‘appreciate what interest on money meant’.

The three clichés which are the stock-in-trade of the merest tyro in debate upon taxation were very much in evidence. The goose with her golden eggs; the money which insists upon ‘fructifying in the pockets of the taxpayer; and all the efforts that we were making for posterity, so that posterity ought to share in the burden’—all these took a more than usually prominent part.

Mr. Hewins spoke of a general tendency to underrate the economic power of Germany, and struck a note of utmost seriousness. Economic proposals must no longer be looked at solely from the ‘old historic Treasury point of view’ as to their success in raising a large sum of money, but also from the point of view as to how far they actually assisted in prosecuting the war. He foresaw that in the ensuing three months the general lines for prosecuting the war for a long period would be laid down. From the second point of view he found the Budget disappointing. He took the curves of direct taxation and of the price level from 1905 and found that they fluctuated together, but he hesitated to suggest the actual nature of the relationship, and would only insist that if taxation were increased, direct and indirect, they must be dependent on production: ‘the higher your tax, the more you have to produce to pay it’. This led him to express the view that, unobjectionable as the excess profits duty might be in principle, there was widespread objection to its application. ‘It is certainly too high.’ The import restrictions and prohibitions had ‘broken down’ and he thought better results could be obtained by a general tariff. It was alleged that the steps were

taken too hurriedly and without proper consideration or consultation of affected traders. Restriction began with wood-pulp and went on to tobacco, furniture, iron, cars, cotton goods, china, and was an ill-assorted medley of interests relating to released tonnage and luxurious display.

Mr. Hewins claimed that the budget had quite ignored our Imperial responsibilities and resources and the conditions to be met at the end of the war. To him Colonial preference was the key to the future. We had reached a stage in the war at which the turn given to economic policy would be an important contributory cause in determining the fortunes of war.

It fell to the lot of Mr. Austen Chamberlain, Secretary of State for India, to reply in defence of the budget, and he felt his position strange in view of his past sympathies with Mr. Hewins on fiscal questions. He laid great stress on what the country was doing compared with others. 'Compare the strength, the elasticity, and the vigour shown by this effort, cheerfully borne by the nation—cheerfully borne by every class of society in respect of that portion of the burden which falls upon them—compare it for a moment with the efforts of our German foe. It is only a few months ago that the German Minister of Finance was boasting that he had not added to the burden of his countrymen during the war. I think that is not perhaps an achievement to boast about. He does not now, because he has found it necessary to add to their burdens. What is the sum which he anticipates that he may perhaps get from his various taxes? A sum of £25 millions of additional taxation, compared with the £300 millions extra which we are able to raise.' On the subject of the onerous level of the excess profits duty he reminded the House that the Chancellor had been pressed on all sides to raise the rate. One or two had prophesied that it would have to be raised again. 'I hope they will not yield to further pressure. In my opinion the tax has gone as high as it ought to go. If you take it any higher you do two things, you cripple industry and you discourage enterprise.' He definitely joined issue on the comparison between the effectiveness of prohibitive duties and prohibitions. Mr. Chamberlain concluded by referring to the striking acceptance of the budget on all sides and in all parts of the country.

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‘I think it is satisfactory that, having this great burden to bear, the spirit of our people has enabled them to sustain it with such readiness and good will, and that after nearly two years of war we should find ourselves bearing comparatively willingly a burden of taxation which would have seemed incredible to any Chancellor of the Exchequer a comparatively few years ago, and that our financial position, instead of growing weaker, as the war goes on, grows stronger with the experience we obtain, the confidence which we acquire, and the respect that we win by the efforts we are making.’

The doctrine that too much was being raised in taxation came in for severe criticism from the Labour members. In the relation between ‘compulsory service’ and ‘compulsory taxation’, the sacrifice of the one was far greater than the other. The profits of the White Star Line were prominent in the public mind, with a dividend of 65 per cent. after paying excess profits duty and also putting ‘enormous sums’ to reserve. Shipping had quite displaced flour milling as a focal point of agitation. Such dividends were regarded as ‘tempting Providence’ when regard was paid to probable post-war requirements. Mr. Mackinder wanted to ‘ earmark’ the proceeds of the excess profits duty ‘if the exigencies of the war do not force us to use it in the future’, as a fund for setting industry going after the war. The idea of the requirements of businesses in competition with trade abroad after the war was in constant conflict with the desire for greater revenue for taxes. Mr. McKenna asked those who did not see in the 60 per cent. rate a sufficient charge, to remember ‘that if they destroyed capital in the hands of those who can best use it, in the long run they will prove the worst friends of labour’. He refused to make a charge of extravagance against any class, despite numerous cases of individuals with high wages or profits spending larger sums than they ought to spend. There was, for example, a diminution in the consumption of meat by the civil population. ‘I regard the power to raise this gigantic revenue primarily not as a fiscal, but as a moral triumph.’

The conflict between the constitutional excess profits duty and the doubtfully fiscal munitions levy was destined to create much heated discussion. Sir John Harwood Banner complained

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that the *rapprochement* between the two departments was altogether incomplete. 'We have heard of Cabinet disagreements and we know that Ministers do not always see eye to eye, but here are two Ministers in the Cabinet who have had this subject under discussion all this time and they cannot settle how they are to treat fairly and honestly the controlled establishments with which they are dealing. That is a great discredit to the Cabinet . . . they ought to look honestly and squarely towards the interests of the nation and the interests of the firms with which they are concerned.' In reply Mr. McKenna rather pooh-poohed the idea of any friction. 'The Hon. Member considered the relations between the levy and the tax were so dubious that he doubted whether the Ministry of Munitions and myself could be on speaking terms. I am happy to be able to assure him that not only are we on speaking terms but that we have talked together either directly or vicariously so frequently upon this subject that I hope we have come to arrangements which may prove administratively satisfactory. I quite recognize there is an apparent divergence of principle . . . but looking to the history of the dates I do not see how that divergence could possibly have been avoided.'

On the 29th May 1916 the Chancellor moved a resolution 'entirely novel in the financial history of our country', imposing an extra 2s. in the pound income tax on such foreign securities as the Treasury had declared themselves willing to buy to support the exchanges. Our purchases abroad, from the United States in particular, were by this time so large that the balance of trade was heavily against us, and the only means of balancing the account was the sale of our own foreign securities, after our exports, including gold, and foreign loans had carried us as far as they could. This is not the place to discuss the financial expedient of the Government buying securities belonging to individuals. Many had responded to the invitation, others, however, had been 'I will not say negligent, but inert, shy, and while conscious of what their duty may be, have allowed that consciousness to remain inactive'. What had been a torrent had of late become little more than a trickle. This new tax was not so much a fiscal measure as a 'spur to remind them of their true duty'. If

it failed to be the necessary stimulus, he proposed to make it 5s., 10s., or even 20s. in the pound. There were, of course, objections that no tax ought to be used as a penalty or as a punishment; moreover, it was a bad precedent for Free Trade doctrine—‘*taxation for revenue only*’. The hardship of being compelled to part with securities at a time of depressed prices was treated as a dangerous precedent. But these complaints were rebutted by the appeal to current compulsions and sacrifices in all directions. A spirited debate resulted, however, in the resolution going through without a division. Later, when Sir F. Banbury again raised the hardships, a member accused him of having ‘forgotten the kind of war which is going on and that we are fighting for our very existence’.

There was a long interval, until the 21st June, before the Committee stage began, and it took five full days and ended on the 28th June. Several concessions were soon announced. The rate of income tax on army and navy pay was reduced, and the limit of income below which claims could be made for children’s allowances was raised from £500 to £700, while the tax on unearned incomes was modified in the lower graduation.

The temperature at the start was perceptibly lower, and a 5s. income tax was said to be unwisely high when so much was being borrowed—an easy opening for Mr. Montagu to follow. But it elicited first a promise of the committee of inquiry after the war to deal with graduation, and then administrative mitigation by interim payments, and allowances of relief against the hitherto rigid and sacrosanct Sch. A assessment on property, instead of by repayment, where possible.

The ‘driving of companies abroad’ plea was revived, and Mr. McKenna replied: ‘It is my firm conviction that the great majority of our countrymen are willing to work as hard for the State as in their own business . . . the payment of the 5s. will not withdraw one iota from their energy or determination to carry on their business as successfully as possible. I am sure, moreover, that in the case of the great majority not one will be tempted to remove his business from this country where it is taxed to another where it may be free of tax.’ He admitted that he would not be so sure in peace time! A great onslaught was made on

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the time-honoured question of the incomes of co-operative societies, but it was successfully headed off with the promised post-war inquiry.

The War Savings Certificate interest hidden in the terms of repayment was to have been exempt for incomes under £300 a year, but it was found better to abandon income limits and to restrict the holding to 500 certificates.

In the discussion of the Motor Spirit Licence Duty we find a typical exclamation: 'If it is desired to stop people from motor-ing to races, why not stop the racing itself? There is an almost unanimous feeling that if you object to racing in war-time you should stop it; but you should not try to do it by stopping motorists from doing what they are entitled to do.'

The first question to go to a division was the relief for Colonial income tax. The Bill provided for the British tax to be reduced to 3s. 6d. where the reduction was fully covered by double pay-ment abroad, but the plea was for the *whole* of the Colonial, or as we should now say, Dominion, income tax to be deducted from the British tax. This meant obviously that the British Exchequer suffered the *whole* relief, and was at the mercy of every increase in the overseas tax, which would thus not fall upon the taxpayer. The Government succeeded by 128 to 32.

The great battle of the debate raged round the excess profits duty on concerns liable to the munitions levy, 4,000 in number. There were attempts to exclude them, then to force the ad-ministration of the duty to adopt the allowances granted—on much more bureaucratic lines—for depreciation, and this was practically conceded.

Disagreement between the two Departments, or at any rate between Mr. McKenna and Mr. Lloyd George, was repudiated, more in details of overlapping accounts and allowances than in the general spirit of the parallel imposts, and the debate moved backwards and forwards on breaches of faith and personal ques-tions in a way which was very intriguing and politically signifi-cant at the time, but which has lost its interest to-day. For the Inland Revenue ultimately took over the whole administration of the levy and its story is briefly that the taxpayer paid which-ever was the higher of the two 'imposts'. There was never any

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final agreement as to the constitutional position of the 'bargain' made between the owners, subject to restriction of profit, and the workers, who gave up their regulations. But Mr. McKenna stuck to the constitutional position of the all-embracing character of tax proposals, and the impossibility of allowing contracting out of any kind. Mr. McKenna was, at that date, able to say with regard to the personal difference between himself and Mr. Lloyd George, 'It is absolutely without foundation to allege there is a divergence of opinion between us on this subject.' The division gave a Government majority of 158 to 72.

The debate on the purchase or borrowing of securities by the Government (the alternative to which was special taxation) related mainly to the reasonableness and efficacy of the proceedings for protecting the exchange and hardly to taxation as such. In the same way the desire to prevent too great relief being given to the particular form of saving by insurance, owing to the high rates of tax, presented special technical difficulties which did not touch the root principle involved.

An interesting attempt was made by Mr. Peto, who was indefatigable in efforts to get specialized treatment for particular classes, to secure a motor spirit duty allowance for a minister whose car was being 'used by him for the purpose of his calling', and thus add him as a class to doctors and veterinary surgeons. It must be remembered now that the idea of ministers generally being in possession of cars struck many as being rather humorous, and the plea finally came down to a few in the sparse districts of Scotland, who had had 'cars given them by their parishioners'. At a later stage the proposal was revived and defeated by 93 to 37.

In the course of a special attempt to alter the excess profits pre-war standard in particular cases Mr. McKenna mentioned that at that date (28th June 1916) there was already under assessment for the first year £21 millions, and there was £6 millions collected. The final figures of assessment for the first period in the preceding Bill was £26 millions, and this was nearly all assessed. All the special and hard cases put forward did not lead the Government to budge upon any amendment which would have reopened all such cases.

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The special treatment of bowling-greens, and exemption of band enclosures in public parks from entertainments duty reflected the diversions of the people, and sidelights on the changes in individual fortunes brought about by the war came through a discussion on the remuneration of managers and directors. In order that the excess profits duty should not be evaded through the process of reducing profits by deduction from higher remunerations, the remuneration allowable had been restricted to the sums payable in the standard years. But it transpired that in some cases, under agreement, the amounts payable had reached £50,000 or even £90,000 (as percentages on profits) and the company having paid this away was compelled to pay duty on it also, and a new provision was introduced entitling them to recover it from the recipient.

The extraordinary extent to which woodlands were being cut owing to the war and restrictions of imports led to special taxation problems.

On the 11th to 13th July the Bill reached its final stages, with the interminable intricacies of life insurances, herb or botanic beer, woodlands again, and controlled establishments. A serious charge was made that the entertainments duty had 'ruined the industry', and to sustain a plea for exemption of those where the charge was not more than sixpence. It was disclosed that in the first six weeks £400,000 had been paid, or say £3,500,000 p.a. on the basis of the 'worst six weeks of the year' against an estimate of £5 millions for the year. The Chancellor was prepared to reconsider the tax on more extensive and later evidence and the democratic plea for poor children had to wait over.

Attempts to get more generous treatment than the Government concession for soldiers and sailors were defeated by 79 to 15—indicative of the very low ebb to which interest in the budget proceedings had fallen.

The third reading was a half-hearted business. A few topics were spasmodically revived and grumbles about the excessive taxation were met by recent reports of shipping profits of 187 and over 200 per cent. 'Especially is there indignation at freights which increase the cost of food and manufactures—the most

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effective way to prevent these high freights is for the Chancellor to take all the profits.'

The conclusion was a simple but impressive assurance that the new taxes would be levied in as fair and reasonable a way as was possible, and the second year of the war closed down upon a foundation well and truly laid. The actual yield of taxes in the year was £348 millions.

CHAPTER IV

PAYING THE BILL

AFTER the great preparatory efforts of the second year the country and the administration set to with a will to make the plans effective. The experiment of the excess profits duty became a grim reality, and the disillusionment of the numerous supporters who had fondly imagined their 'special circumstances' would relieve them from direct attack was complete. My recollections of this active formulative period to the end of 1916 have a background of mingled pride and disgust at the real and false patriotism of the taxpayer. But the main preoccupation of the people was with the growing conviction that the war was an even more desperate business than any one had suspected. One after another crucial episodes on which public hopes had been centred went awry and the Press broke away from its close support of the administration and became critical and even hostile. Submarines got on their nerves as the food supply was more and more in jeopardy, and an uneasy feeling became stronger that Mesopotamia had been bungled. Rumania gave trouble and upset the Eastern balance. Mr. Lloyd George was the centre of new hopes, but this is not the occasion to tell the story—even yet not fully revealed—of Mr. Asquith's resignation on the 5th December 1916 and Mr. Bonar Law's failure to form a Government. Under Mr. Lloyd George as Prime Minister, Mr. Bonar Law became Chancellor of the Exchequer, but as he was also a member of the War Cabinet, and Leader of the House of Commons, he was always hard pressed. It is commonly supposed that he was too hard pressed to give full consideration to budget problems, but as a matter of fact he contrived to give much time to sounding individuals about new proposals, and as he often veered from point to point and back again, and was frequently uncertain behind the scenes of his own mind, he gave himself more trouble than was strictly necessary, for although he had the reputation of being a practical business man, with an experience in the iron business, he did not so readily assimilate new principles in finance as his predecessor. He was extremely quick and resourceful in

debate, and an unrivalled parliamentarian, to the extent that he tended to judge alternative issues, not so much on their fundamental propriety, as by the ease with which he could get them through the House. His manner was conversational, disingenuous, and disarming, so that he often scored by a bland manner where pedagogy would have failed.

The budget was not introduced until the 2nd May.

Mr. Bonar Law had prepared his budget speech with meticulous care, word for word, with his officials. But on the occasion itself he spoke actually with a few notes only, as was his wont, and succeeded in conveying an impression of great lucidity and exactness through his conversational manner and short sentences. As a matter of fact, he was often dealing with technical questions demanding highly exact terminology, and a careful comparison of the verbatim *Times* report and the ultimate Hansard reveals an unusual number of minor corrections or 'adjustments'. 'Rapidity was his most notable characteristic', said Toby. 'Unhampered by manuscript (save a couple of sheets of notepaper containing a few of the principal figures) and relying on his exceptional memory, he rattled through his thousand million totals at such a pace that my panting pencil toiled after him in vain.'

He expressly eschewed rhetoric, and desired nothing more than to continue the methods of his predecessor in the presentation of his case. Expenditure, £2,198 millions, had exceeded the estimate by nearly £373 millions, exactly met by the excess on the Votes of Credit. This was largely due to increased costs of munitions and £100 millions increased advances to borrowers, which then amounted to £970 millions. Revenue exceeded estimates by £71 millions, only Customs and Excise being in deficit (£9 millions), but tobacco showed an excess of £1½ millions. Excess profits duty reached £139,920,000 or £53,920,000 in excess, which was due mainly to payments in advance carrying interest—a method not arranged for until after the estimates were made. Income tax and super tax were £10 millions in excess. The increased use of cheques had mainly brought about an excess of £2 millions in stamps. The Chancellor showed the effect of balancing the budget by various types of borrowing, and the

position of the floating debt (£464 millions Treasury Bonds outstanding), and the National Debt had increased by £1,714 millions to £3,854 millions.

In pursuance of his predecessor's ideas of covering net debt by permanent taxation, he gave these figures: Revenue, excluding excess profits duty and interest on loans £416 millions. Pre-war expenditure £173 millions and £30 millions additional for pensions and education made £203 millions. The balance would provide £153·7 millions to pay off the debt in forty-two years at $5\frac{1}{2}$ per cent. and leave a balance in his favour of upwards of £59 millions. He said that 26 per cent. of our expenditure was being met out of revenue and there was 'no belligerent country which by any possibility could present a figure so satisfactory'. After a brief disquisition upon the economic advantages and disadvantages of a low rate of interest, he revealed his new taxation proposals. Taxation was so heavy that 'in whatever form, it must diminish capital available at the end of the war'. This had to be weighed against the alternative burden of debt. He had carefully examined so many proposals that he thought it impossible for any member to make a suggestion he had not covered. All had been rejected for two reasons, first the disturbance and cost were not compensated by the yield, and second, and more important, staff was lacking. From the Inland Revenue alone 3,000 men had joined the forces. The remainder were greatly burdened with new duties, and additional tasks would mean a loss of a larger amount of revenue elsewhere. He therefore proposed no new taxes, but only additions in the existing ones. The entertainments tax did not actually condemn recreation. 'I recognize the value of amusements to the public at the present time . . . I feel, and I have no doubt other hon. members feel, that to attend a theatrical display with all that it means at a time when we know what is going on in France, is against our sympathies. No nation will show its best strength . . . if it is always brooding—there must be some means by which they can forget.' He disclaimed any puritanic feeling and quoted Burke: 'The man who always toils can never have a sound judgement. He never gives himself time to cool.' The additional tax proposed was to yield half as much again as the previous year

(£3 millions). The rate on the *1d.* and *2d.* tickets was left at $\frac{1}{2}d.$, but free or complimentary tickets were charged.

Tobacco, he supposed, with the inveterate smoker's sly smile, was a luxury, but personally there were few necessities which he 'would not rather do without'. The previous year's heavy addition had not reduced consumption—a sufficient justification from the revenue point of view. Seventy per cent. of consumption was in a form 'of which I have never been able to see the attraction', viz. cigarettes, cigars accounted for 5 per cent., and pipe tobacco the balance. An additional tax of *1s. 10d.* per lb. was to yield £6 millions. He thought that this particular addition, 'better than most', would enable the burden to be passed to the consumer.

Amid applause on all sides Mr. Bonar Law then launched his proposal to increase the 60 per cent. excess profits duty to 80 per cent. He would have been glad to leave it alone but for the necessities of revenue. But in any case when the general privations were considered he could not regard it as unfair, or any one as badly used if he got a larger income during the war than he got before. Despite what deputations had said there was no form of taxation which, on the whole, would be fairer or less detrimental to national interests. The increase was to be made retrospective, viz. as from the 1st January 1917, and indeed the Prime Minister had given a warning of this possibility. The munitions levy was to be merged with it, and the new incentive to production in controlled establishments, though small, was not entirely negligible. We have revolutionized our industrial processes . . . 'the rapidity of the recovery of the country after the war will depend on the use we make of the new methods, of the new machinery, and above all, on the extent to which the old hostility between capital and labour can be removed'.

Modifications in the excess profits duty were then announced. New capital introduced into a company's business was to carry 9 per cent. instead of 6, and 11 instead of 7 for private firms, the additions to be given to all the different awards for special industries. He dealt at some length with the shipping trade. Ninety per cent. of all ships of 1,600 tons and upwards were being requisitioned. The system of requisitioning vessels and of

fixing freights had tied down their profits, and it was not proposed that the sums so regulated should be 'brought up to the pre-war standard' (which for ships was relatively high) by repayments from previous years, under the 'deficiency' clause generally available. This was perhaps discrimination, but it was justified by the large profits they had made prior to being requisitioned. The increased yield of excess profits duty was put at £20 millions under this head. Farmers could not be successfully taxed even if only the 12,000 assessments of farms rented at £400 p.a. and over were involved, for the yield of £300,000 would be exceeded by the cost of collection.

The total revenue was estimated at £638·6 millions (tax revenue being £569·7 millions). This left £1,651·78 millions to be provided by loan. He concluded by asserting that it would not be want of money that would prevent victory, and we could go on longer in this respect than our enemies. The speech was simple and unrhetical, but it created a great impression.

Mr. McKenna's immediate reply drew attention to the fact that the country was now relieved from all further anxiety in the purchase of foreign supplies and the maintenance of the dollar exchange, since the immense resources of the United States 'are now being used directly in the service of the war'. The Chancellor was thus no longer troubled by anxieties which had beset his predecessors. The estimate of two millions favourable balance of taxation over expenditure on a peace basis was low because credit had not been taken for income tax on War Loan interest. Every estimate of daily expenditure on the war that had been made hitherto had been below the truth, and he was afraid the latest would be equally so, owing to the upward march of prices. Hitherto it had been possible to limit prices only in domestic production, but he suggested that the United States might not be adverse to an agreement for limiting prices of her exports. He showed the reasons for the excess over the excess profits duty estimate and congratulated the Board of Referees on the celerity of their action, and drew the moral of the negligible contribution of munitions levy, as due to a greater complexity and difficulty in administration. People would exhibit wonderful willingness if they understood a tax and thought it fair. But he

expressed doubt whether raising the rate of duty from 60 per cent. to 80 would (with the income tax and super tax on the balance) ultimately prove justified.

The subsequent debate showed the old spirit of inevitability. The House was nearly counted out after a few regular but undistinguished talkers had reduced it to a handful of listeners, and it rose soon after eight o'clock after taking the chief resolutions. The speeches covered ground now largely familiar; an odd plea for protective duties; satisfaction that the munitions levy was to be merged with excess profits duty, and some speculation about its details; a plea for larger allowances for repairs to houses for income tax and the encouragement of house-letting; Labour objections to the entertainments tax and the taxation of co-operative societies (to excess profits duty); a renewed plaint on the incidence of excess profits duty on new businesses. There was also a powerful plea upon double income tax in the Empire, with the particular instance of Australia, with 6*s.* 3*d.* in the pound Commonwealth tax, 2*s.* State tax, and 5*s.* British tax, making 13*s.* 3*d.* in the pound, without regard to super tax. Mr. D. M. Mason expounded his view of the responsibility of increased note issues for the constant rise in prices and joined issue with the Chancellor's earlier statement (13th February 1917) as to the ease with which the country would discharge its debt.

'The total expenditure since the beginning of the War had now reached the colossal figure of £4,200,000,000, and it was estimated that at the end of the financial year the total National Debt would be between £3,800,000,000 and £3,900,000,000, £890,000,000 of which was represented by advances to our Allies. It was clear that we could not spend at that rate for ever, but it was also clear that we could bear such a financial strain longer than our enemies, and once the war was over, if it should prove necessary to keep taxation up during peace at the same level as it had reached now in time of War, we should be able to wipe the whole of the National Debt away in a comparatively short time.'

Mr. Baldwin, acting as the new Financial Secretary, replying for the Government to the several points raised, promised adequate depreciation allowances to controlled establishments, proposed to remit the double taxation problems in income tax to a Commission to be appointed after the war, and pointed out that arrangements had been made to avoid double taxation under

excess profits duty. He revealed that the additional percentage rates for new capital had been suggested by the Board of Referees. The new strain under which the fishing and merchant fleets were working was revealed by the fact that their men were to be brought within the death duty concessions given to regular army and navy services. The income-tax allowance for 'adopted' children seemed also to have some relation to the development of war conditions.

On resumption the discussion was hardly more vigorous or distinguished, despite individual contributions of some originality. Mr. Sidney Arnold (in later years Lord Arnold) wanted a tax on titles, and he also made a detailed criticism of the budget figures, demanding £30 millions increased taxation to provide a proper peace basis, and suggesting 6s. 3d. in the pound income tax, with the super tax level reduced to £1,500. The land taxers made their usual plea, while the repeal of the exemption of professions from excess profits duty and the more exact handling of farmers' profits were demanded. It was suggested that the working men would want to change the excess profits duty because of its effect upon employment and prices, and there was a mild plea for raising the income-tax exemption limit from £130 to £160 because of the increased cost of living. Mr. Healy made a case for Irish interests—the age-long 'over-taxation', the disproportionately small sums spent in Ireland out of the large expenditure by the Government, the effect of liquor licences and tobacco taxation in Ireland, and finally an appeal for the Government to buy the Irish railways. Mr. Bonar Law contributed again to the budget discussion proper, setting the optimists against the pessimists. He rebutted Mr. Arnold's assumption that the Allies 'would not be able even to pay us interest on their debts to us at the end of the war. I am sure that is wrong. Unless we are defeated I see no reason to suppose that they will not be able to pay us interest on the loans'. To the hon. gentleman who wanted more money out of mining royalties, he replied that the total charge in income tax, super tax, and excess mineral rights duty might actually reach 95½ per cent. He said that the insignificant yield of munitions levy was due to complex rules and a new machine—some £20 millions would actually be pay-

able for the coming year. He then announced a new tax on dogs, not as a revenue proposal, but in order to discourage unnecessary maintenance, the tax being graded on each additional dog kept by an individual. This aroused Mr. Swift MacNeill, who objected to a new tax being introduced unawares in an empty House, and to the Chancellor immediately absenting himself and thus avoiding all criticism of it—a criticism which he proceeded to develop on passionate and sentimental lines. The injustice to country against town, to Ireland against England, to the Pomeranian against the St. Bernard, and the general ‘outrage’ to Parliamentary procedure, made no impression on a listless House. *Punch* said:

‘The secrets of the budget were so well kept that Mr. Law himself forgot the most important of them until to-day. In future it will be a case of “one man (or woman) one dog”, unless the owner is prepared to pay on an ascending scale for his extra pets. To get the Kaiser back to his kennel we will, if necessary, empty our own. Doggedness is essential to victory, but not over doggedness. Then let us in Calverley’s phrase “curtail the already cur-tailed cur”.’

The other resolutions attracted only small attendances and it was curious to find the excess profits duty being debated, at this late date, on the basis of a special tax on profits ‘due’ to the war. A fortnight later (24th May) the second reading debate was taken, and the details did not come into Committee until the 2nd July. The spirit of the second reading discussion was well expressed by Mr. Snowden:

‘We are discussing the second reading of this unparalleled proposal this afternoon with an attendance of less than one-fifth of the members. I do not profess to be able to explain the reason for this indifference to the important question of war finance. I might make two suggestions—one is that a sort of fatalism appears to have fallen on the people of this country. They seem to think that things will be what they will be and that no human effort can alter them in the slightest degree. Perhaps another reason is that these people have been interested in matters of national finance and taxation in the past, and are so busily engaged now in making enormous war profits that they have little time to attend to the other aspects of the question . . . in years after the war we shall have to pay very heavily for the indifference which has been shown.’

No doubt the latter part of this comment was characteristically acidulated, but there is no question about the listlessness

of parliamentary discussion. The Chancellor agreed that people did not want to upset the proposals submitted, and that that was 'not a bad frame of mind'. One member said it was pure patriotism to acquiesce in the general principles, and the best service to criticize incidental flaws.

Mr. Bonar Law answered his critics on the main question of the margin of permanent taxation left after the war, by the argument that the increased volume of production would give a peace revenue on the basis of existing taxation much in excess of the current figures. He said the crux of the debate was the treatment of shipping (*vide* p. 193) in excess profits duty. In requisitioning ships they were to be given a fair rate of profit, but the untrammelled operation of excess profits duty provisions was to allow repayment out of their past payments in such wise as to give them practically their pre-war standard 'guaranteeing the pre-war rates'. But these pre-war rates had been exceptionally high, some 15 per cent.—and this was too high a rate to guarantee. At this point he made his famous personal revelation, disingenuous to a degree:

'I am going to give to the House what I did not intend to do, and what will, perhaps, interest hon. Members. It so happens that when I was in business in Glasgow I myself had certain small investments in ships. When I mention the rate per cent. of profit the House will think that I must be a rich man. Perhaps I had better disabuse them of that idea. The total amount of the investment was only a few hundred pounds in each ship. I was a shareholder in fourteen ships. Taking the average of those ships, all of them paying very well, the rate of dividend I received last year was forty-seven per cent. after paying the excess profits tax. I do not say that that is typical of the whole shipping community. They were capitalized at the value they cost. I do not know beyond that, but at all events, what I am going to say my hon. friends will understand perfectly well, and that is that for every £100 I put in I received £47 last year after excess profits had been paid. None of the vessels were sold. Now, here is the position. The Government have undertaken, in the interests of the nation, to take over the ships; at the same time they have undertaken that fair remuneration shall be given to the shipowners. I say that that promise would not have been fulfilled if we had made an arrangement which practically guaranteed to the ship-owners—considering the profit they have made during the period of the war till now—the equivalent of the pre-war rate, which was something near fifteen per cent. I do not for a moment believe that any fair-minded man will

consider that that is an arrangement which in all the circumstances is unfair to the shipowners, or one that ought not to be ratified by the House.'

This statement brought Mr. McKenna to us in the official gallery frankly amazed at such *naïveté*, as it seemed in the then temper of the House upon the subject. The policy adopted towards the shipowners was described as a 'man in the street' policy, and the Chancellor was invited to extend it to the farmer. Sir John Harwood-Banner had begun to raise the difficult question of valuation of stocks and stores, on which he had seen me many times personally.

'The question was as to what steps would be taken now to adjust the excess profits created by the instructions of the surveyors to *everyone to revalue their stocks and stores*. The answer I got treated the matter as a very small point, and said that if I would bring the case forward—as if it was one case—the Chancellor of the Exchequer would kindly have it looked into. As a matter of fact, it is not one case, but it is 10,000 cases that want looking into in this respect. I met a distinguished official in Somerset House—I hope the gentleman will not mind my repeating our conversation—and he said, "You did not expect to get an answer, did you?" I said, "No, perhaps not." He added, "It would have taken us many closely written pages to answer you, and then it would only have been half done." Yet the Chancellor of the Exchequer, in the usual Treasury way, treated this as if it was one case of hardship which had to be enquired into.'

This valuation question was destined to be the storm centre of the excess profits duty until the end of the tax. It was highly technical and is dealt with in a later chapter as a connected whole.

The increase in the cost of living was beginning to appear regularly as a factor in many contentions, and here the exemption limit of £2 10s. per week was called into question, but the feeling extended to the lower ranges of the 'amusement' tax and cheaper kinds of tobacco. For example: 'No tax ought to go on 6d. tickets or downwards. Those who buy them receive the smallest wage and they really deserve a little recreation. They may have husband or sons at the front. . . .' 'I plead for those who smoke the twenty-five per cent. and ask that no tax should be put on them because they are generally unskilled labourers and carters

rates, postponing the increases till the 1st October, and dropping the duty on the 'dead heads' or free tickets.

He then announced that he was going to halve the proposed increase on tobacco duty, and he thus cut short a spate of speeches. But his proposal to increase a liquor licence rebate from one-quarter to three-quarters was opposed as a gratuity to the brewers of one million sterling, which they little needed, for about a hundred had increased their profits and forty-one had remained unreduced. It was explained that the object was to relieve the retailer whose hours of sale had been seriously reduced, whose supplies were curtailed, and whose profits were much reduced. Many of the 176,000 licensees could not tell exactly what profits they were making and only a rough adjustment was practicable, but the objectors were overruled rather than convinced. On the income tax, the indefatigable Mr. Basil Peto again urged the case of soldiers' pay and met with a measure of success, for his point was admitted, and it was agreed to make the allowances apply to unearned income so as to have the full earned income chargeable at the reduced rates.

The excess profits duty again provided the main interest. First, the date at which the change of rate should apply was always troublesome, for, as the chargeable accounting periods began on different dates, it was supposed that each concern ought to suffer an equal period at the several rates, and it was thought wrong to apply the new rate from a fixed date, the 1st January 1917, because that resulted in very varied periods under charge at the 50 and 60 per cent. rates. Attention was drawn to the 'appalling waste' produced by the tax. 'The fact that the man who controls expenditure is only going to get 15 per cent. out of the expenditure, because 80 per cent. is paid by way of excess profits duty and 5 per cent. in super tax, does produce a very bad spirit throughout the country . . . a readiness to chuck away money on all sorts of people who ought not to have it.'

The vexed question of the valuation of stocks was postponed to be dealt with in a White Paper and left the shipping interests in possession of the debates, with expostulations against the differential taxation and charges of 'profiteering'. It was stated

that all other countries were encouraging shipping by giving subsidies and exempting from taxation, and pleas of post-war maritime impotence and loss of prestige were strongly urged. Mr. Bonar Law was able to reaffirm that prodigious freights and profits were contributing in no small measure to the high cost of commodities, making it difficult to deal with labour. To allow such a state of affairs to go on was to make it useless to appeal to anybody for sacrifices. He rebutted the suggestion that he himself had been specially favoured in his shipping investments, and gave exact personal details. He had invested in fifteen different shipping companies under seven different owners. They were tramp steamers, not liners, and he thought they were a fair representation of profits being made.

‘I am going to give the Committee the figures. I gave them in percentages the other day, but I do not think the Committee quite realized what they meant. The sum of money I had invested in shipping spread over these fifteen companies was £8,110. Five per cent. interest on that, which in ordinary times I should have been glad to get, would be £405. For the year 1915, instead of £405, I received £3,624 and for the year 1916 I received £3,847.’ (Mr. C. Duncan: ‘Good Lord!’ Mr. Denniss: ‘Was that after paying excess profits duty?’ Mr. Bonar Law: ‘Yes.’ Mr. Hogge: ‘What about conscience money?’). The Chancellor went on: ‘I said it was a risky business to bring these figures before the Committee, because I felt quite certain there would be a suggestion that I should pay conscience money to myself. That does not end the matter. I agree it is a great advantage to the Country that there should be money put into ships if necessary, but prudent managing shipowners do not divide all the profits. There is something to come to me later. One of these steamers has either been sold or sunk, I do not know which. . . . In that ship I had £200, and after the very handsome dividend which I received, on liquidation I received a cheque for a little over £1,000. That is not my only experience. There was another shipping company, in which I invested £350. The other day I received a letter from the managing owners saying that because the cost of building was so high and likely to continue high, it was not probable they would wish to invest the money in ships for a long time to come; therefore they were going to make a division out of surplus capital. For that £350 capital, on this division, I received a cheque for £1,050. That is the trade we are ruining! I say at once that the mere fact that the Government have allowed shipowners to make these excessive profits is no reason for treating them unjustly now—it is not their fault—but I do say in view of the profits they have made in the past, that for us to consent to an arrangement which would prac-

tically guarantee them fifteen per cent. profit after we had taken control and after we had said we were going to limit their profits, would have been unfair to other industries and to the taxpayers of the country.' (Hansard, 3rd July 1917, 983-4.)

Mr. McKenna described it as the 'most convincing candour' he had ever heard, and was at pains to deal with his own ministerial pledges, first that deficiencies below the standard would be set off over the whole period of the tax, and second that any ship built during the war could be written down at the end to post-war value, and any loss so created dealt with against profits. As soon as these were embodied in an Act, ministerial responsibility ceased—Parliament took the responsibility and could vary its own decisions—no Parliament could bind its future. On the merits of the case he felt the influence of so sudden a change would be bad, and discrimination 'without inquiry into individual cases' was unsatisfactory. The land taxers exclaimed that this example of picking out the villains would be in due course 'the thin end of a very valuable wedge'.

The overwhelming statistical facts were, however, that, in 1913, ships worth £200 millions had made £20 millions and, in 1916, the same ships had made £250 millions. The gross earnings had been £127 millions in 1913 and were now £410 millions. 'Who had paid these freights?' asked the man in the street, who always finds decisions on general principles difficult when facts are strained to the limit. Mr. Bonar Law got his clause without a division, and announced his new proposals for meeting the case of small, new, growing businesses with a low pre-war standard. But he had to fight a strong attack upon his provision for meeting double taxation with the Dominions, and met the 86 malcontents on the division with 142 supporters. Another division (92 to 47) defeated an attempt by Labour members to raise the exemption limit for income tax from £130 to £150, mainly justified by the rise in the cost of living. From the same quarter came a new effort to get exemption from excess profits duty for co-operative societies. The rise in the price-level had automatically increased the amount, if not the rate, of dividend on purchases, and thus unexpectedly the tax had become payable. Mr. McKenna, who had arranged the original form of charge,

felt himself in a great difficulty and asked for special consideration. When ten days later the new legislation was completed, the Chancellor admitted that there was no logical basis for the imposition of the tax, and desired to put the charge back on the basis originally intended. At this final stage he had the last debates on the probable losses to traders when the values of their stocks should fall at the end of the war, and the famous White Paper (see Chapter VII). Mr. McKenna supported the Government but asked them to keep an open mind to deal with these economic problems fairly as they arose. Mr. Bonar Law was on strong ground when he claimed that, as advised by a panel of eminent accountants, he found the manufacturers' claims 'utterly inadmissible'. The Finance Bill spluttered out in teetotallers' drinks, sugar consumption, amusements, tobacco, adopted children, ships and more ships; and the Chancellor in his concluding speech pleaded that nothing could now be done without serious disadvantage, and all that was possible was to keep this at a minimum. The credit of the country was being well maintained—all classes were submitting to taxation with willingness, though 'every person thinks he has been treated worse than his neighbour'.

One noble Lord in the Upper House made a little speech about insurance premiums and heavy death duties, and so brought the third finance year of the war to a close. In that year the yield of taxation had been raised to £531 millions against £193 millions before the war.

Mr. Bonar Law invented and imposed nothing new. He increased many existing charges, and gave many concessions. As a consequence, new taxation was lagging behind increased expenses, and the rapid rise in prices was widening the gap between them, and creating a crop of new economic problems which were only dimly foreseen.

CHAPTER V

THE LAST YEAR AND THE FINAL EFFORT

THE spring of 1918 was a grim and disillusioned period, full of half hopes and redoubled fears. Finance was a mere detail in the deadly outlook of food shortage, and ultimate collapse.

Mr. Bonar Law introduced his budget on the 22nd April 1918, and promised to make a greater demand on the time of the House than previously. He was concerned to show first of all that Britain was self-supporting. Out of £950 millions advanced by the United States, £500 millions was to ourselves, but we had lent to the Allies £505 millions (as against £540 millions the previous year). Our accounts were swollen by these entries and he was in contact with the Finance Minister of the United States and making suggestions as regards these advances which would lessen our burdens and in no way increase the obligations of the States. He was sure that these suggestions would receive 'most sympathetic consideration'.

Revenue showed an excess under every head of taxation. Excess profits duty £20 millions, income tax and super-tax £15 millions, entertainments duty £500,000 in spite of the increased rates being three months late in application. Tobacco had yielded no less than £1,700,000 in excess of the estimate; miscellaneous items accounted for £25 millions more, due to extra loans in India. Moreover, on balance, the lending by Dominion Governments was in excess of their borrowing. He referred to Mr. McKenna's principle that the basis of revenue in force at the end of each year should be wide enough to meet the debt charge existing about that date, so that new taxation would not be required on the cessation of hostilities, and he claimed to have adhered to it. The issues for the year 1917/18, £2,696 millions, had been met by revenue, £707 millions, and £1,989 millions borrowed. For 1918/19 the estimate of expenditure was £6,986,000 per day against £6,583,000 in the preceding year—a total of £2,972 millions. Existing tax revenue would give £774 millions, or £67 millions more. Excess profits duty was estimated to yield £300 millions, and new taxation £67,800,000. The total

revenue was estimated at £842 millions, leaving a balance of £2,130 millions for borrowing. The end of the year position was given as follows: Pre-war non-debt expenditure £173 millions, post-war pensions £50 millions, education, &c., £97 millions; total £270 millions. The gross debt would be £7,980 millions, and he took the burden of the Russian debt in full, but deducted £816 millions as one-half of the total Allied debt, or £1,124 millions, including the Dominions and India. At $5\frac{1}{2}$ per cent. upon £6,856 millions, he reckoned £380 millions as the debt service. The total post-war budget would be £650 millions. The existing taxation would yield £540 millions, and therefore £110 millions of new taxation must be imposed to preserve the principle. His actual propositions would yield £114 millions, and he took no credit in his computations for the income tax in the sums at the moment taken for excess profits duty, assuming the profits to remain on their existing level. Various floating stores were an asset worth £375 millions, while land, securities, buildings, and ships were worth £97 millions and munitions stores, £325 millions at cost, could be put at £100 millions, making 572 millions in all as at the end of the preceding year and £672 millions at the end of 1918/19. The excess profits duty collectable after that date would be £500 millions, and thus the total assets were £1,172 millions, or £300 to £400 millions more than the sum taken into credit as due from the Allies.

For four years to the 31st March 1918, revenue was 26·3 per cent. of total expenditure and for 1918–19 it would rise to 28·3 or 26·9 for the full five-year period. If 200 millions were deducted as normal revenue and expenditure, the tax percentage was 21·7 for four years, 26·5 for 1918/19, and 23·3 for the five-year period. The total *war* revenue raised by the end of the year would be £1,686 millions. ‘The financial strength of the country, after five years of war, will be far greater than any one could have expected in advance . . . an amazing testimony to the financial stability of the country.’

The German comparison gave an expenditure nearly equal to our £6,250 millions. Their total war taxation was £365 millions against ours of £1,044 millions. Their deficit on revenue account at the end of the year would be £385 millions per annum at

least. Moreover, they had taxed the masses in the main and had been afraid to tax the rich. He drew a disparaging picture of the general financial stability of Germany.

In the imposition of new taxation he made three points: First, the necessity for maintaining the stability of business; second, the lender must regard the security as good and not overwhelmed with burdens, and third, that he must not abuse the willingness of the House to levy drastic taxation. He had negatived the proposal to increase the rate of excess profits duty because he was told he might get less revenue. But he would bring the sales of goods in the mass (where whole businesses were realized) into the tax, but not retrospectively. Post Office rates were to be increased $1\frac{1}{2}d.$ instead of $1d.$, yielding £4 millions in a full year. Doubling the cheque stamp would give £1 million p.a. Income tax would be raised from $5s.$ to $6s.$ in the pound. (Hon. Members, 'Hear, Hear!' and 'not enough!') 'I hope the exclamations I have just heard reflect the general view of income-tax payers.' In a full year this would yield £41,400,000, but only £11,500,000 in 1918/19 owing to the instalment system. But the income tax up to £500 a year and upon the service pay of soldiers and sailors would not be raised. Nor would the extra shilling be payable where the combination of taxes at home and in the Dominions reached $6s.$ in the pound—it would stay at $3s. 6d.$ in the pound. He proposed to extend the children's allowance to the wife 'and so far, much to my surprise, I have had no representations from women's suffrage societies suggesting the impropriety of proceedings on that basis'. Incapacitated dependants were also included, but their allowances would be limited to incomes up to £800 (in place of £700). The super tax maximum rate was raised to $4s. 6d.$ from $3s. 6d.$ and the tax was to begin at £2,500 in place of £3,000. This would yield £14,150,000 in a full year. Actual rates on an income of £3,000 would become $6s. 5d.$ in the pound, on £10,000 $8s. 4d.$, and on £20,000 $9s. 5d.$ in the pound.

Farmers had been getting off too lightly. Over 90 per cent. kept no accounts, but that was no reason for excusing them from a just contribution. But the remnants of the taxing staff, bearing an almost intolerable burden, could not possibly cope with

such accounts. They had to concentrate on the large sources of revenue, and risk evasion. He proposed therefore to take the farmer's profits as equal to twice his rent, in place of the actual rent. This would do rough justice between different types of farming. Moreover, any farmer had the option of giving actual results by accounts. They must not impose hindrances to food production. The revenue in a full year would be £5,300,000.

Dealing with spirits and beer, he said the trade position was entirely artificial. The commodity was so scarce, and the desire for it so great, that sellers, left to themselves, could get almost any price. But prices were regulated by the Food Controller. The spirit duty would be raised from 14*s.* 9*d.* to 30*s.* per proof gallon, bringing in £11,150,000. The beer duty would be doubled, 25*s.* to 50*s.* per barrel, bringing in £15,700,000 in a full year. If he had foreseen the big profits that had been made there would have been a change before. In any case, if they now made low profits they would recover 80 per cent. of the deficiency compared with pre-war profits. The tobacco duty was to be raised from 6*s.* 5*d.* to 8*s.* 2*d.* per lb. The consumption had greatly increased and the Tobacco Controller considered that the higher price could be got, provided the consumer were not irritated by being unable to get the article he was willing to pay for. Therefore they must be careful not to restrict tobacco imports too greatly. This would yield £8 millions. An additional duty on matches would yield £600,000. Sugar would have to bear an additional tax of 11*s.* 8*d.* per cwt., bringing in £13,200,000. Its price had been fixed at 5½*d.* per lb. and would now be 7*d.* The ration was ½ lb. per week, and the burden on the consumer, therefore, 1½*d.* per fortnight. They must not forget the subsidy on the loaf in this connexion. His last proposal was a luxury tax. In the previous year he had rejected it because of its difficulties. But it had been imposed in France, and its operation there had now been studied. He took as a guiding principle the French method: Their tax included, (1) a tax on luxury articles, classified as such, regardless of prices, e.g. jewellery; (2) articles which, beyond a certain price, could be treated as luxury; (3) luxury establishments such as restaurants. A Select Committee of the House would prepare the schedules in order to get the additional sanction of

such a course for such a novel impost. The tax would be higher than the French 10 per cent., viz. 2*d.* in the 1*s.*, or one-sixth, worked by a stamp duty. He did not venture on an estimate pending the preparation of the schedules. He concluded by expressing the usual confidence in the willingness of the House and the country to bear this heavy burden.

Mr. McKenna agreed that the budget had satisfied the cardinal principles. He urged that, under the new conditions, American lending to the Allies should no longer be passed on *through* Great Britain. 'We will go on financing ourselves from first to last, but we may reasonably ask that.' He blessed the luxury tax within limits: 'If it were my duty to impose the tax and to collect it, I should break down hopelessly, but I have such confidence in my friend's greater abilities that I am quite sure he will succeed in devising a scheme.' But he chaffed the Chancellor on having retired from the task and left it to the members. As regards the yield of revenue in future, he gave the warning that the good years would be succeeded in the three years' average by years in which controlled profits prevailed. He also commented on the happy gamble which was enjoyed by those who had invested in tax-free war loan before they knew the privilege would be so valuable. Mr. J. H. Thomas, speaking for Labour, could not congratulate the Chancellor on the boldness of his proposals. The increased postage would be a tax on correspondence with the soldiers, and, generally, an increase in administrative expenses. Personal profit was likely to be made out of the tobacco tax, and, any way, tobacco was almost impossible to obtain. The income tax, starting at £130, was now equivalent to starting at £65, because £1 was equal to 10*s.* previously in spending power. Mr. Thomas urged that the death duties should have been increased. Other speakers pointed out that direct taxation now reached over 82 per cent., and the Government ought to begin to build up the indirect section till it reached 50 per cent. over a period of years. The usual generalities were contributed by the recognized budget speakers—Sir J. Walton, Sir F. Banbury, Mr. Peto, and Mr. Lough. The cheque tax was criticized as restriction, and the statements about the weight of the sugar duty were challenged, for it was pointed out that the

burden did not rest only on the ration, but also on all the articles of consumption into which sugar entered. There was a demand that the results of control by the various Commissions, whether profit or loss, should be produced for inspection. The debate proceeded in a listless House—one member remarked that it had emptied after the Budget Speech and even the Chancellor of the Exchequer himself had gone! There was practically no complaint about the increase of income tax and excess profits duty, but from the Labour benches came suggestions that the latter should have been raised to 90 per cent. or there should have been conscription of wealth. The luxury tax was generally approved though there were occasional doubts as to its practicability. The increase in the sugar duty was perhaps most unfavourably received, but nowhere was there real hostility to any proposal—the taxes were ‘what the Nation expected’. New suggestions included alterations in the incidence of entertainment duty—a tax on fancy names for residences—‘Mon Abri’ or ‘Mon Repos’ was a bit of vanity worth paying for—a general tax on land values with a yield put variously at £3,000 millions to £6,000 millions; the remission of the Agricultural Rates Act; relief to general double taxation, particularly with America; a new kind of excess profits duty after the war, and extension of the duty to professions. What would be the effect of the new spirit duties on spirits for medicinal use? was one of the detailed applications of the new proposals. Soon after ten o’clock the resolutions were put and twenty-two were passed without a division! This represented the very limit of parliamentary indulgence.

The next day Sir Herbert Samuel led off and the debate ran till shortly after nine o’clock. It raised mainly the question of slackness in financial control over expenditure, and was not very critical of the new taxes. Sir Herbert Samuel, as an old Postmaster-General who had held office for five years—a longer period than any known in modern times—objected to the increase in postage, and also to the minimum charge of 6*d.* for parcels. Mr. Baldwin, for the Government, acknowledged that money had been spent too lavishly in munition wages—‘it was part of a bitter and heavy price we had to pay at that time—bound to lead to further trouble in all directions in the manufacturing and labour world.’ He defended

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the relegation to Committees of the luxury tax detail, which would lend itself so much to the 'quasi-humorous' method of treatment. The answer to those who urged a 100 per cent. excess profits duty was easy. Another member gave a revised calculation of the percentage raised in taxation by ignoring the money lent to others and asserted that the true figure was 36 compared with 44 per cent. for the Napoleonic wars. 'A National Debt today which is not two years' income of the country is sufficiently clear proof that the present ability of the country to meet the National Debt is far higher than it was after the Napoleonic War.'

Then followed a speech which, in my judgement, was in most respects the most remarkable effort of any in all the financial debates of the war. Mr. (since Lord) Arnold (formerly on the Stock Exchange in Manchester and becoming recognized as a speaker on financial questions) began by stating a twofold position—that the increase of taxation was insufficient, and that it would be better sooner or later to meet a large part of the liabilities by a levy on capital. An elaborate examination brought him to the point that the post-war revenue would be £650 millions, showing a deficiency of £70 millions, which would involve an increase of the income tax to 7*s.* 6*d.* in the pound apart from super tax. Such a serious prospect brought him to his main project. He put forward the levy as a business proposition, helping credit by a display of strength. He took the taxable capital at £24,000 millions. There were to be two levies, the first immediately, and the second two years later. It would touch individuals only, on the same principle as the death duty (which was at an average rate of 10 per cent.) and would yield 12½ per cent. upon a graduated scale. Fortunes of £1,000 were to be exempt, £5,000 would pay 4½ per cent. in all, £6,000 would pay 12½ per cent. and the large fortunes higher rates. The debt would thus be reduced from £6,000 millions to £2,000 millions. He took as his first basis the now well-known 'writing down' argument—the income-tax payers were relieving themselves of their own burden. His second was the necessity for repaying debt before prices should have fallen 50 per cent. and thus doubled the difficulty of the task. He dealt with several objections: (1) the disinclination of

opponents to consider the facts about future income tax as an alternative; (2) the drying up of capital—which he contended would be made freer—no cash would be *required* for the transaction; (3) that securities would be thrown on the market at ruinous prices. He suggested that the levy could be met by handing over war stock, by exchange through the Treasury, by credit facilities, by cash payments; (4) that the valuation was impossible. Then he took ethical grounds—there was ‘something almost indecent about the quibblings of older and wealthier men’. He spoke for seventy minutes with hardly a reference to a note, and although I had heard all the debates for five years, and may be regarded as by then rather hardened and perhaps cynical, I found the cool and efficient presentation a most masterly performance, delivered as it was to a rather thin and listless House.

The one member who was stung to reply relied on a refutation of the *ad captandum* argument about sacrifice of young life *versus* sacrifice of elderly wealth, and on the penalty for past thrift, the fear of repetition, and the shock to credit.

The Postmaster-General defended the new postal proposals by showing that the postal profits were much less than had been supposed after reckoning war bonuses and separation allowances to the staff. It was urged that those liable to excess profits duty were spending abnormal sums in advertising. The battle for the farmers was interesting though not very vigorous. Mr. Bonar Law in his reply was thankful for the cordial reception of his budget, which showed that he had dealt fairly with those who had to make sacrifices. He dealt with the chief criticisms. Farmers backward in accounts would be helped by the Board of Agriculture local agents, but they were having too good a time to be let off. The stamp duty on cheques was now acceptable to bankers—it was a very different state of affairs from that prevailing at the time of the Boer War, when the banks were in opposition. It would check inflation, for ‘cheques are inflation as much as Treasury Notes’. The postal charges would merely serve to put the Post Office back to its old position, having regard to the extra cost of service. The sugar burden would be balanced twice over in the ordinary working-class household budget by the subsidy on the loaf.

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All agreed that the luxury tax was desirable, and there was only scepticism as to its workability—but for a Committee of members to tackle it was an opportunity for ‘war-work’. In the matter of economy, they were getting back to a commercial basis after the immense drive that had been made. He finished by a reference to the great increase in the *scale* of expenditure—munitions so greatly beyond the pre-war years—the building of 900 miles of full gauge railway and 1,000 miles of light railway behind the lines in France. Several long speeches followed upon liquor licences and the capital levy. In the case of cheques the arguments of 1902 were resuscitated to prove the great weight of the burden upon small cheques, and the consequential effect on the demand for currency notes and silver, and the cost of carrying on small businesses. The debate on the resolutions was not resumed for eight days owing to the intervention of business on the Increase of Rents Bill and Munitions, when one evening sufficed to dispose of this stage. It was enlivened by two of the rare divisions of the period. The sugar tax was vigorously criticized, and the calculations made upon the sugar ration that the burden would be 2s. 8½d. per week on the family was countered by the calculation of 5s. resulting from dividing the total estimated yield by the population. There were two main defences: (a) that the burden must be spread over the whole people, and (b) that it was not really a burden, because in the case of the income tax payers it was offset by the new allowances for children, and in the case of the others by the bread subsidy. To the latter point it was rejoined that a most roundabout way had been chosen—why not reduce the subsidy? The Chancellor used the goodwill of the House to get along, and the division resulted in 141 to 56. He obtained his first intimation that there would be no organized opposition to the heavy licence and beer duties, the chief effective criticism being directed to the point that the beer would be so much diluted as to cause trouble with the perspiring working man who, while needing quantity to make good his losses, also wanted quality to satisfy his taste. Then came a determined effort by the manufacturers to get income tax depreciation allowances extended to buildings and other assets, to take the determination from the Local Commissioners

and put it with the Revenue Department, and to alter the basis from actual 'wear and tear' to 'what a provident trader would charge'. The Chancellor complained that he was replying to a new House on each grievance, as its exponents were interested in their proceedings only. The division was 110 to 40.

The discussion on farming was chiefly interesting for the evidence as to the position of woodlands and the cutting of timber under extraordinary war conditions.

There was no opposition to the so-called 'Whisky' clause for excess profits duty. Traders with heavy stocks which had reached high values knew that they would pay over 80 per cent. of the profit, so that numerous cases were arising in which the whole business was disposed of as a capital transaction. The tax—non-retrospective—was to rope in such sales so far as the stock was concerned. These proceedings ended tamely and the latter stages were even more listless. Criticisms by Mr. McKenna went to show that the main budget calculations were too optimistic and the Chancellor would have to raise a further £1,250 millions from home borrowing, apart from £500 millions abroad. Mr. Snowden criticized any indirect methods of luxury taxing as 'amateurish', childish, pettifogging and ineffective, and appeared to be relying upon a single direct tax upon income, but he was not altogether with his own party when he criticized the proposal to raise the minimum beyond £130, for he thought that no considerable body of voters should be free from the financial effects of questions which they were influential in deciding. Committee proceedings lasted two days only and produced only small amendments in the entertainments duty and tax reliefs for children—an encouragement to have a reasonable British family of 'an old-fashioned kind'. By the 21st June the Bill went to the Lords and actually produced a speech—an interesting comment upon the parallels of German finance from Lord Emmott. The last war budget became law on 31st July 1918. Its course had been listless, subject to little opposition, and with perhaps undue satisfaction, deceived by the apparent increase in the total productivity due to the change in price-levels, which rather tended to exaggerate the apparent burden.

The one really new feature of the last war budget was

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destined to meet an untimely end. The luxury tax had disappeared from the Finance Bill 'to be introduced later'. On the 17th October Mr. Bonar Law said that at so late a date in the session he felt compelled to abandon the project for the moment, but the work of a Select Committee would not be wasted, for in the next budget that work could be utilized on the revival of the project. But it was destined not to be resuscitated, and actually the last act relating to taxation during the war was the act of abandonment of a special and much heralded war tax, for the Armistice was declared very shortly afterwards.

The story of the post-war budgets cannot be told here. The aftermath is too long a record and the psychology was totally different. Mr. (now Sir) Austen Chamberlain had to meet a very different set of problems and held out no hopes of a normal year for a long time to come.

The abolition of the land values duties, the replacement of the motor spirit duty by revised licence duties, Imperial preferences, the dropping of the luxury tax, the increase in duties on spirits and beer, the discussion of the special levy on war wealth and its rejection, the long agitation for a capital levy—finally relegated by a Labour Chancellor to a Special Committee—the long heralded Royal Commission on the Income Tax and its recommendations, the introduction of a new corporation profits tax, and not the least the winding up of the excess profits duty, were the main incidents of the first four or five years of the post-war era, with continual disappointments at the slowness of tax reduction. Of these matters only the concluding stages of the great tax invention of the war, the excess profits duty, belong to this volume.

PART II

CHAPTER VI

TAXATION AT THE OUTBREAK OF WAR AND MODIFICATIONS DUE TO WAR CONDITIONS

TAXATION has been rightly described as having played a more important and more striking part in Great Britain in sustaining the burden of the world war from 1914 to 1918 than in any other belligerent country. Whether it be measured by the aggregate sum raised, by its proportion to the national resources, by the amount paid per head of the population, or by the proportion of the total war expenditure met by taxation, this view can be well maintained.

An American observer, Mr. Harvey Fisk, has drawn attention to the 'amazing fact that for the six fiscal years between the 31st March 1914 and the 31st March 1920 the total expenditure actually exceeded the total for the two and a quarter centuries preceding, during which £10,944 millions were expended. The people of Great Britain paid into the coffers of the Government, in taxes and other revenue collections, over thirty-six per cent. of this vast sum of more than eleven thousand million sterling.'

Foreign observers have marvelled at the patience and resolution of the taxpayer, at the elasticity and variety of the sources of revenue, and at the resourcefulness and efficiency of the administration. It has been said, with perhaps some pardonable exaggeration, that nowhere else could such a sight be seen as England could show in her citizens coming forward and clamouring to be more heavily taxed for the winning of the war. 'Englishmen and their newspaper editors are diligent in heckling and finding fault with the Government, but to the observer 3,000 miles away, quietly studying the figures without any other object than to get at the facts, the results achieved seem little short of marvellous.' They could only be reached in a country where patriotism was so high that the public begged earnestly to be taxed heavily.

Taxation during the war begins, properly speaking, with the Budget and Finance Bill that became law just before the declaration of war, for it was upon the funds provided by this

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scheme that the war, during the first five or six months, so critical and determining a period, was actually conducted.

The nature of the movement during the war can be properly appreciated only if the position of taxation prior to 1914 has been clearly understood. In 1913/14, which, it must be remembered, came on the crest of a period of excellent trade, the national expenditure amounted to £173 millions, excluding the charges of the Post Office, and was made up broadly as follows:

	<i>Million £.</i>
National Debt Services	24·5
Local Taxation Grants	9·7
Army	28·3
Navy	48·8
Civil Services and Revenue Depts.	58·4

The revenue to meet this was mainly collected as follows:

	<i>Million £.</i>
Customs	35·4
Excise	39·6
Estate Duties	27·4
Stamp Duties	10·0
Income Tax	47·3
Land Tax	} 3·4
House Duty	
Land Values	
Duties	

The Customs consisted entirely of tariffs imposed for revenue:

	<i>£</i>
Cocoa, coffee, and chicory	562,000
Currants, raisins, &c.	514,000
Spirits	4,436,000
Sugar	3,277,000
Tea	6,508,000
Tobacco and Snuff	18,290,000
Wine	1,155,000
Motor spirit	824,000
Other duties	105,000

The Excise revenue was composed as follows:

	<i>£</i>
Beer	13,623,000
Spirits	19,540,000
Railway Duty	288,000
Glucose and Saccharine	56,000
Patent Medicines	360,000
Playing Cards	34,000
Liquor licences	4,330,000
Carriages, cars, &c.	708,000
Other receipts	717,000

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The income tax was charged at the rate of 1s. 2d. in the pound on incomes over £700 (incomes derived from personal exertion being charged at 9d. if below £2,000 and 1s. in the pound below £3,000). Incomes under £160 were exempt, and between £160 and £700 the tax was graduated up to the full 1s. 2d. The super tax had only recently been instituted and was charged on all incomes exceeding £5,000 at 6d. in the pound on the excess of the income above £3,000. It was paid by 14,000, upon £175½ millions, and raised £3,240,000 in 1913/14.

The estate duties had been reconstituted in 1894 by Sir William Harcourt, and ranged from 3 per cent. on estates of £5,000 to 8 per cent. on estates over £1,000,000. In the great Liberal budget of 1907 Mr. Asquith steepened the progression by raising the rate at £200,000 from 6½ to 7 per cent. reaching 10 per cent. at £1,000,000 and 15 per cent. on still higher fortunes. The Lloyd George budget of 1909 increased the whole scale from 4 per cent. at £5,000 to 10 per cent. at £20,000 and 14 per cent. at £1,000,000. In the 1914 budget, immediately prior to the war, the progression applicable to estates of £100,000 and upwards was again increased.

The principles underlying the income tax had, within the previous decade, been materially modified by graduation and differentiation, but it was still, in the main, administered upon the system which had served for over seventy years.

It will be remembered that the income tax had stood without material change of principle from 1894, when the merest elements of graduation were introduced by Sir William Harcourt, to 1906, when one of the first acts of the new Government was to appoint a Select Committee, under Sir Charles Dilke's chairmanship, to consider the questions of differentiation and graduation. During that period the tax had been the mainstay of finance for the Boer War, with no modification other than an increase of the rate from 8d. to 1s. 3d. in the pound, and from 1904/5 for five years it had settled down steadily to the normal rate of 1s. No graduation existed for incomes over £700 a year.

The recommendations of the Committee of 1906 were not immediately translated into law. Differentiation between the rates on earned and unearned incomes was carried out in 1907

on the lines laid down by the Committee. This having been accomplished, graduation of the larger incomes followed in 1909 in the form, approved by the Committee, of a super tax on incomes over £5,000, an additional tax of 6*d.* in the pound being imposed by direct assessment on the amount by which the income exceeded £3,000. The extension of the system of abatements which the Committee had reported upon favourably was not adopted, but a new step was introduced into the rates on earned income, incomes of that class paying 9*d.* up to a total income limit of £2,000, 1*s.* up to £3,000, and the full rate above that amount. The position after the 1909/10 Act was, therefore, that there was graduation by exemption and abatements for all incomes not exceeding £700, graduation by rate in the case of earned incomes only up to £3,000, no graduation between £3,000 and £5,000, and finally graduation by super tax on incomes above £5,000.

This position continued until 1914 without change, but the first Finance Act of that year, the last Finance Act passed before the outbreak of war, carried the principles of graduation very much farther. Hitherto the graduation had been almost entirely confined to the incomes at the two extremes of the scale; now the middle incomes were dealt with, though only in a partial fashion. The rate on earned incomes rose by five steps instead of three to the maximum rate, which was reached above £2,500; unearned incomes went by three steps to the maximum rate, which was charged on incomes over £500. The super tax limit was reduced from £5,000 to £3,000, and the super tax, instead of being charged at a uniform flat rate of 6*d.*, was charged at seven rates rising from 5*d.* to 1*s.* 4*d.* in the pound.

The scale of rates existing at the outbreak of war had not been tested by experience. From the famous 1909/10 People's Budget, the standard rate was 1*s.* 2*d.* in the pound, with an 'earned' income rate of 9*d.* for incomes up to £2,000 and 1*s.* to £3,000 and £10 allowance as relief for children. The super tax was charged on all incomes over £3,000 at 6*d.* in the pound.

People opposed to the programme of social expenditure then sanctioned had complained frequently that we had encroached upon our 'war reserve', and misused this powerful engine of war

finance. The rate had certainly never been over 1s. in previous history, except in time of war.

The resultant rates for 1914/15 were 1s. 8d. as a standard rate, and for earned incomes 1s. up to £1,000, 1s. 2d. to £1,500, 1s. 4d. to £2,000, and 1s. 6½d. to £2,500. But there was a very important and administratively disconcerting innovation in dealing with 'unearned' incomes of small amounts. The rate upon such income, when the individual's *total* income was under £300, was reduced to 1s. 4d., and where the total did not exceed £500 to 1s. 6½d. This was the thin end of the wedge, so far as tampering with a uniform normal rate was concerned, for the standard rate had become too high to be applicable to small incomes, and the abatement system did not lend itself to proper relief. No interference with the normal course of deduction at the source being possible, a new class of repayment claimant arose, and an era of individual attention to the case of incomes which had always automatically adjusted their liability under the old system began. The super tax which, being assessed 'globally'—to use a French description—in one sum, lent itself to any variety of rates, was graduated on a new system, later described as the 'slice' method, which was based upon the model of the estate duty in its higher grades. On the first £2,500 nothing was chargeable, but on the next £500 5d. in the pound; the fourth thousand bore 7d.; the fifth 9d.; the sixth 11d.; the seventh 1s. 1d.; the eighth 1s. 3d. and all above £8,000 1s. 5d. This method secured an even graduation of *effective* rates, without any 'jump' or break at the points of change, which always characterizes the 'abatement' system of graduation. When the first war budget was introduced the rates were increased by one-third and became 6½d., 9½d., 1s., 1s. 2½d., 1s. 5½d., 1s. 8d., and 1s. 9½d. respectively.

There were several other subjects which developed in importance during the war owing to the *weight* of war taxation, and thus were hurried in their natural evolution. The first was that of double taxation.

While the exemption of unremitted income had led to anomalous results, as between different taxpayers of equal actual ability to pay, some of whom decided to leave income abroad to

be invested there, while others preferred to invest it at home or required it to be remitted to live upon, this measure undoubtedly gave a strong impetus to the agitation on the subject of double taxation. The Dominion Parliament had been imposing income-tax laws from about 1893, and occasional attempts were made by private members to ventilate the question in amendments to Finance Bills.

A change in the attitude of the Government towards this question became noticeable in 1911, when the subject was discussed at the Imperial Conference and a resolution to abolish double income tax within the Empire was moved on behalf of the Colonial Premiers. The Chancellor of the Exchequer, while expressing sympathy with the proposal, said he could not afford to give up the revenue involved, and it was on this ground that the Colonial Premiers did not press the point.

The new measure stopped up one of the escapes from the evils of double taxation, but it did not become an effective instrument of charge for some little time.

The subject of double taxation within the Empire had been discussed in Parliament in a series of debates from the latter end of 1915. Mr. McKenna, on the 4th April 1916, when foreshadowing Section 43 of the Finance Act, 1916, said: 'The subject is one which will have to be dealt with in the promised reconstitution of our income tax laws'; and in the meanwhile he must content himself, where the Dominion tax is not less than 1s. 6d., with not imposing any fresh burden. An amendment was proposed that the British income tax should be repaid up to the amount of the Colonial income tax paid, or wholly repaid when the Colonial rate was not less than the United Kingdom rate. Mr. Montagu replied that the amendment would mean a vast loss of revenue, whereas the Government clause, while sacrificing some revenue, would ensure that the evil was not exaggerated pending a thorough examination of the whole question.

The first legislative attempt to alleviate the hardship was made in 1916, by Section 43 of the Finance Act for that year. This section was admittedly only a rough-and-ready expedient, and was introduced as 'a temporary measure, and without prejudice to future consideration of the relative claims of the

Exchequers of the United Kingdom and of the Dominions' (Financial Statement printed on page 9 of House of Commons Paper No. 50 of 1916).

Section 43 provides that where a person has on any part of his income borne both United Kingdom income tax (at more than 3*s.* 6*d.* in the pound) and Colonial income tax, he shall be repaid:

- (a) such an amount as will reduce the United Kingdom Income Tax on that part of his income down to 3*s.* 6*d.* in the pound, or
- (b) the whole amount of tax on that part of his income at the rate of the Colonial Income Tax, if that amount is smaller than the repayment under (a).

As the rate of income tax in 1916 was 5*s.* in the pound, the maximum relief under Section 43 was 1*s.* 6*d.* in the pound.

Mr. Bonar Law in 1917 refused an amendment under which the United Kingdom would have remitted tax down to 1*s.* 6*d.*, pointing out that any colony imposing a tax at 3*s.* 6*d.* would receive all the duty and the United Kingdom would get nothing.

When in 1918 the income tax rate was raised from 5*s.* to 6*s.* no alteration was made in Section 43 of the Finance Act of 1916, which was made to apply in its original form to the year 1918. In the result the maximum relief became 2*s.* 6*d.* in the pound, the whole of which was borne by the United Kingdom Exchequer.

It may be remarked that the considerable discussion both in Parliament and outside on this subject had been directed almost wholly against the continuance of double taxation within the Empire; the taxation of the same income both in the United Kingdom and in foreign countries does not seem to have aroused so much comment until well after the war.

The second matter which was brought to a head owing to the weight of taxation was the joint assessment of married persons to income tax.

It had been found in practice that in many cases the husband did not know and could not ascertain his wife's income, and in 1911 the Commissioners were empowered to ascertain it from her and assess her on a proper proportion of the tax due on the

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combined incomes. In 1914 an important alteration was made, and it was enacted that, where an application for the purpose was made by either a husband or wife, income tax (including super tax) should be assessed, charged, and recovered on the income of the husband and on the income of the wife as if they were not married, but in such a case the total reliefs or allowances to the husband and wife, or the total amount of super tax payable, would remain the same in aggregate amount as if an application under the section had not been made, and, broadly speaking, would be divided between husband and wife in proportion to their respective incomes.

The Finance Act, 1918, by granting an allowance of the tax on £25 for a wife, recognized for the first time that the limit of income at which a married man can afford to pay tax is higher than in the case of a bachelor. This allowance has not fully met all the claims which have been put forward in this connexion. Sometimes the suggestions took the form of proposals to tax the bachelor at a higher rate than the married man. Mr. Lloyd George, in 1909, speaking on a proposal to grant separate assessment of a married woman as though she were unmarried, pointed out that married persons had a joint duty in regard to household expenses, with the natural result that the family income as a whole was looked at in considering the ability to pay taxation.

The tendency of recent legislation, by allowing deduction for wives, children, and dependent relatives, had been in the direction of having regard to the family circumstances of the taxpayer when laying the tax burden upon him, but there had been a certain amount of criticism on the ground that this tendency had not gone far enough and proposals were made for its extension. For example, a publication of the Fabian Research Department during the war, suggested that:

‘So far as incomes not exceeding £2,500 a year are concerned, whether earned or unearned, it should be open to any person assessed to ask that all the taxable receipts of all the members of his family, living in the same household with him and sharing in its expenses, or maintained elsewhere wholly or partially at his expense, should be aggregated for assessment as a family income, and that family incomes so arrived at, should, for Income Tax purposes, be divided by the number of members of the family . . . *actually maintained therefrom*. There could then be

allowed from the combined family income whatever abatement each portion of such income would justify if it were that of one person only.'

The Financial Secretary to the Treasury said:

'I have no doubt it will be one of the principal objects of the Income Tax Committee . . . to see how the incidence of the income tax . . . can be so organized that it shall fall fairly on men according to the demands made on them for the families which they have to bring up and the homes that they have to keep, and according to the incomes with which they have to keep up those homes.'

Allowances for children had apparently been given under the old subsidy Acts, and in Pitt's Tax of 1798 an abatement of 10 per cent. was given if there were *at least* four children, 15 per cent. for 8 children, and 20 per cent. for 10 or more. In his 1799 income tax, allowances were graduated according to the income assessed, but they were dropped altogether in 1806, owing to trouble and inconvenience and too much fraud. It was not until recent times that the growing public demand for a more accurate adjustment of the tax burden to the taxpayer's ability brought the question of an allowance for children prominently into notice. Some slight references were made to the subject by witnesses before the Select Committee of 1906, but as it was not within the Committee's terms of reference the inquiry was not pursued. The matter was, however, raised in the House of Commons on more than one occasion in 1906, and the Chancellor promised it consideration.

In 1909, after the lapse of over a century, the allowance for children was revived. Mr. Lloyd George, in his budget statement for that year, having referred to the steps already taken in the direction of differentiating between earned and unearned income, said: ' . . . it remains to complete the system . . . by taking account, to some extent at any rate, not only of the source from which income is derived, but also of the liabilities which the taxpayer has contracted in the discharge of his duties as a citizen.' The Finance Act for that year contained a provision for the allowance of the tax on £10 for each child or stepchild under 16 years of age, provided that the total income of the taxpayer did not exceed £500.

The allowance granted in 1909 was several times extended

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and enlarged during the war. By the Finance Act, 1914, the amount of the allowance was doubled; the Finance (No. 2) Act, 1915, increased it still further to the tax on £25 for each child; the Finance Act, 1916, extended the limit of the parent's income from £500 to £700; the Finance Act, 1917, granted the allowance in the case of adopted children; finally by the Finance Act, 1918, the limit of the taxpayer's income was again raised to £800, and, where the total income exceeded £800 but was not more than £1,000, allowance was granted for each child above the number of two.

Modifications in existing taxation due specifically to war conditions

The very high rates of duty which war finance necessitated in themselves, of course, made obvious and insupportable various anomalies and defects which had hitherto escaped practical attention. Such, for example, was the effect of a change of abatement at a particular level of income, where one with an income just over the limit was positively worse off in his net income than one who fell just below it, owing to the diminution or cessation of his allowances. This was met in 1916 by providing that at such a point the tax payable was not to be greater than applied to an income actually at the limit, plus the actual income above the limit, and the effect of this proviso was to make a 'zone' of variable gross incomes, just above the critical point, for which the corresponding net incomes were identical.

Conversely, those high rates of tax sometimes seemed to give a particular form of relief an undue advantage when proportionately magnified. Thus the tax relief obtained by the right to deduct life-insurance premiums from income increased with each increase in income tax, and was much greater for people with large incomes. This led to a restriction of the relief to an amount of tax calculated at the lower rates. But apart altogether from the consequential changes through high rates, war conditions themselves necessitated modifications in the existing scheme. Obviously the first to show itself clearly was the inequality of charging death duties on deaths which occurred quite out of the course of nature, through war itself. The precedent

of the Boer War was quickly revived and provision made for relieving the estates passing more than once, owing to death from wounds, accidents, and disease caused by the war, and shortly after it was logically extended to succession and legacy duties. Not till 1917, however, when mines and submarines were causing havoc amongst merchant shipping and all types of citizens were serving, was the relief extended to the masters and crews of ships and fishing boats, dying from operations of the war. When the war was over it was found necessary to give a period of three years during which such deaths might occur, and also to provide that death resulting from wounds inflicted, accidents occurring, and disease contracted after the war, but arising because of it, would come within the relieving statute.¹

Under the income tax, provision was soon needed for the immediate and astonishing changes in individual fortunes. Payment of tax, based on more prosperous conditions, during a period of severe contraction was likely to inflict hardship. At first, soldiers and sailors and Red Cross workers, whose circumstances were naturally quite changed, were allowed to bring in the facts of the year itself in place of those of the preceding year, for purposes of assessment. Then those liable for super tax were able to postpone payment so long as their actual income was less than two-thirds of the pre-war income. But by 1916 so many people had suffered a severe change in circumstances that anyone, regardless of war service, whose actual income was less than the assessment by more than 10 per cent., could also claim to take the 'actual year'. But the life-insurance relief was not

¹ Relief from death duties was granted in respect of property passing on the death of officers and men of the Navy, Army, and Air Force, members of the Merchant Service, and Fishermen who were killed in the 'present war', in two ways:

- (a) Where the property passed to a widow or lineal ancestor or descendant exemption from all death duties was granted in respect of the first £5,000 of property so passing, and as to any excess over £5,000 the duty was discounted for a period equal to the normal expectation of life of the deceased at the time of his death.
- (b) Where property passed on the *successive* deaths of persons killed in the war, no duty was chargeable on the second or subsequent deaths, to whomsoever the property passed and whatever its value. In 1918 the first type of relief was extended to property passing to certain *collaterals*, viz. brothers and sisters and their lineal descendants, with retrospective effect and covering the case of Lord Clive, to which special reference had been made.

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correspondingly restricted. In 1917 adopted children were made eligible for the children's allowance, and in 1918 the relief for dependent relatives was extended. The increases of rate made payment by instalment necessary in 1915, and as the vicissitudes of the taxpayer's movements made the stipulation that he must claim earned income relief by a specific date practically unworkable and certainly often unfair, all time limit was removed.

The treatment of the pay of soldiers and sailors was constantly and hotly debated during every session. In 1915 soldiers and sailors with incomes under £300 were allowed to pay tax on their service pay at the pre-war rates, but in 1916 a scale of rates applied up to total incomes of over £2,500 at 3s. in the pound. So gradual were the shades of war service into civilian service for war purposes that the relief was defined as due only to those serving with the Colours, or on full pay out of the country, or at least a month continuously in Britain. In 1917 it was extended to the service of a member of a crew of a ship or fishing boat, and in 1918 to members of the Air Force.

From 1916 the additional premiums for insurance to extend its benefits to cover war risks of all kinds were specially allowed as deductions without any restriction of amount. But not until 1917 was any allowance given for diminished value of machinery which had been put out of use through 'circumstances' attributable directly or indirectly to the present war.

The anxiety of the Government to make their Loan Issues as attractive as possible was the origin of special treatment of dividends and interest, which was not in itself always very desirable from the taxation standpoint. It was natural that banks, with their heavy advances, should be allowed to bring interest into their receipts as an integral part of their trading results, and not be any longer liable upon it as an item independent of their profits and losses. But payers of 'free of tax' interest had to make returns of the names of recipients. A special feature of certain issues was the right to tender scrip in payment of excess profits duty and death duties. Trusts were given power to borrow money in order to subscribe. The differential taxation on foreign securities which the Government desired to obtain

to support the exchanges and help pay for our heavy imports has been referred to already. Woodlands were a special feature, owing to the heavy cutting of timber to obviate imports, and the right to deal with them as a trade and not by heavy annual taxation on a conventional basis under Schedule B was admitted.

At the first opportunity when the war was over, the reduced rates to soldiers, &c., and special terms for diminished incomes were repealed. But legislation was necessary to grant exemption for wounds and disability pensions and for war gratuities to the Naval, Military, and Air Forces, and to all the different officially recognized bodies of nurses.

The Customs and Excise modifications had reference mainly to licence duties on premises affected by the concentration or shifting of population. In 1915 the changing proportions between the consumption of liquor and of other goods in licensed houses required special attention, and the frequent restriction of sale during normal hours to meet special orders of the naval, military, and civil powers (or even made voluntarily) obviously called for a reduction, which became fixed at one-quarter of the licence duty. In 1917 the actual discontinuance of business in licensed premises owing to destruction or serious damage or by reason of prohibition of sale was provided for. Spoilt beer; the import of immature spirits; rum for home consumption; the restriction of delivery of goods from bond to amounts which were reasonable for home use; the 'destruction on board' of goods shipped for export; all were special features of war conditions which called for treatment. The imposition of heavier motor duties called for special relief for vehicles used exclusively, if voluntarily, for ambulance and hospital work, in agreement with the Government for naval and military service, and a similar relief applied to the motor spirit duty.

Upon the whole, it may be said that taxation was affected by general conditions due to the war to a less extent than new economic conditions were themselves created by especially heavy taxation in coal, shipping, and munition concerns.

CHAPTER VII

THE EXCESS PROFITS DUTY

It has been stated by an American observer that the British excess profits duty, if not the very first of the special profits taxes, was 'certainly in most respects the greatest and best of them all. It was established very early in the war, and whatever future research may reveal regarding the early precedence for this form of taxation, the evidence shows clearly that the British duty owes its fitness to no exterior influences.'¹

Dr. Haig says: 'It was an indigenous product—a spontaneous local reaction to a better circumstance which arose in Great Britain with the outbreak of hostilities.' The war had been in progress only about two or three months when the publication of several balance sheets running to the 30th September and the 31st October 1914 aroused the public to the fact that there was a 'war profits' problem. Certainly the most conspicuous of these cases was that of Spillers and Bakers. In this case the profits of a flour-milling company had increased from about £50,000 in 1913 by over £300,000. At the time when this result was published there was a kind of apology to the effect that the result was due rather to accident than design. Public resentment generally centred round those cases which related chiefly to food-stuffs and the necessities of life. Here is a typical outburst:

'I am one who eagerly desired to hear the Chancellor say he would put a tax upon the immense war profits that are being made from the necessities of life, such as bread, coal, &c. . . . The neglect of the Government to tax war profits is an invitation to everybody to rob the public to the utmost. . . . If the Chancellor had stated definitely that he was going to tax all profits in excess of the average earnings over the last three years, that would at all events have given some satisfaction to the country. . . . We are entirely in the hands of the Government. All I can urge is that the Government should not rest quietly and allow people who gamble in the necessities of life to enrich themselves by war profits. . . .'

In November 1914, when Mr. Lloyd George was proposing to increase the rates of income tax for the last third of the year, he was asked whether he would impose in his next budget a special tax with the object of securing for the benefit of the

¹ *The Taxation of Excess Profits in Great Britain*: Dr. R. M. Haig (1920).

State not less than 65 per cent. of the increase of those incomes which were larger during that time of war than they were before the war. The current conception of the proper way to approach the problem was almost invariably from the point of view of total income of individuals. Sir Joseph Walton was prominent at this time with a suggestion that the three years average for the income tax should be temporarily abandoned. He proposed to tax, at the new high rate, the actual income of the year. He thought that it would pass the wit of man to prove in many cases whether such diminutions of income were attributable directly or indirectly to the war. The people who had made the high profits immediately the war broke out should bear, he thought, the new high rate of tax upon them immediately, and not wait for the operation of the three-years' average. The fatal flaw in all such proposals for dealing with income as a whole was that the income tax did not rely to any extent upon individual returns of total income, but upon taxation 'at the source', and this was a totally impracticable basis for an individualistic tax on surplus incomes.

Gradually, however, two ideas gained ground: first, that it was the *amount* of profits, rather than their cause or character, and second, that it was profits as distinct from incomes, that must be the subject of charge.

Thus Sir A. Markham remarked in the House of Commons: 'There is considerable unrest among the working men owing to their thinking that unreasonable profits are being made. A profits tax would do more to increase production than anything else could do.'

Nevertheless, the traces of the original notions continually appeared throughout the war.

A Record of Genesis

It may be of interest, in order to settle any doubts on the subject of origin and priority, to give a brief summary from my own records. On the 27th November 1914 Sir Joseph Walton wrote to Mr. Lloyd George referring to the 'rich harvest being earned in the South Wales Steam Coal Collieries, and to the inequality between the booming woollen industry of West Yorkshire and the depression in cotton in Lancashire'. He asked

for a special war tax on income, the actual income of the year. I reported upon these proposals, and showed the practical difficulties in a system of deduction at the source. In April 1915 I wrote, upon a tentative suggestion by Mr. F. D. Acland, that the three years average for income tax should be altered on this formula: 'Double the last year and divide the aggregate by four instead of three'. The principle was to secure that abnormal results, whether of profit or loss, should be more closely related to the high rate of tax in force during the war. It failed, of course, to discriminate in any way between profits due to the war and those due to increased capital outlay, advertising, &c., and between fluctuations in profits far below the ordinary or reasonable profits and fluctuations much above a reasonable level. The results, moreover, would not have been commensurate with the work and disturbance caused. But before this date I had been busy upon the actual trading results and accounts of 1914, and in March 1915 made the first of a series of reports upon 'Exceptional Profits due to the War'.

Dividing the cases into two classes, those where the year 1914 was less than 10 per cent. above an effective minimum, and those where it was more than 10 per cent. above, I found that the majority of 'excesses' fell into the latter class, showing that if businesses had done well at all, they had done very well. The effective minimum was taken as the higher figure of, first, the average of 1911-13, and, second, 1913 itself. At that time the largest excesses were shown in the industries comprising Grain and Food; Leather Boots and Clothes; Chemicals and Soap; Brewing, Distilling, and Sugar. I concluded that the total excess profit for the cases where profits were more than 10 per cent. above the effective minimum was £18 millions \pm £4 millions, and that this would be heavily reduced if confined to profits 'due to the war'. The work upon the sample cases indicated that the application of any principle of taxation to them as a whole must be considered in relation to the following separate categories:

- (1) Profits made from large new volumes of supplies
 - (a) directly for war services, e.g. armaments, &c., clothing and textiles, steam coal, timber;

- (b) indirectly; certain shipping, invalid chairs, surgical instruments.
- (2) Profits made from price disturbances, more or less artificially produced, or from curtailed supplies; sugar, flour, food-stuffs generally, paper, &c.
- (3) Profits made through exceptional *movement of population* into particular areas; by businesses which were dependent on *local* custom, hotels, cinemas, breweries.
- (4) Profits made apparently through *cessation of imports* from belligerents, e.g. dolls, toys, pianos.
- (5) Profits made from *cessation* of belligerents' *competition* in neutral markets, e.g. (probably) exceptional results for certain lace firms where there was depression in the industry generally ('Capturing Germany's trade').
- (6) Concerns that were showing a rapid and consistent increase working up to a proper return on new fixed capital (e.g. Selfridge's, &c.) where the increase was mainly unrelated to the war.

By June I was hard at it, dealing with different proposals in debates and correspondence, and invented a percentage standard of 8 per cent. for *new* businesses, or such a percentage as 'a given authority' should ascertain as achieved by the established concerns in the same industry.

A preliminary scheme was definitely formulated for taxation of war profits, and approved by the Chancellor on the 26th June in view of the announcement made on the Committee stage of the Finance Bill on the 16th June. It provided for a 'levy on excess profit' before it was distributed which was not to be passed on to individuals. The excess was to be over the higher of the two effective minima, and excesses of 10 per cent. or under were not to be liable. The taxable fund for a full year of war was estimated at £50 millions. The idea of taxing excess *incomes* as such was then dead, but we were still hankering after confining it to profits *created* by the war. The term 'Excess Profits Tax' was first used by Mr. Hartley Withers on the 16th July 1915, during his brief stay at the Treasury as a Financial Adviser, in a memorandum in which he advocated the inclusion of farmers but the exclusion of profits due to war capital, special advertising, legacies, &c.,

and he advocated a 50 or 75 per cent. duty on the excess. I rejoined with a final effort to clear up the constant confusion between the fortunes of a particular trading concern and the fortunes of the several individuals receiving profits from it—‘a scheme based on the two together is foredoomed to failure’—the tax ‘must be related to profits before they become incomes and is not to be directly related to incomes at all’.

By August 1915 I was wrestling with the problem of ships and sales of ships (and using the term ‘excess profit’ instead of ‘exceptional profit’ quite freely) and also with problems of evasion through manipulation between schedules, between concerns, and between different years.

By 31st August we had reached this position in conference with the Chancellor:

‘The duty not to extend to professional men;

(a) standard, 1913/14 tax assessment or 6 per cent. on the capital, whichever was higher;

(b) add 10 per cent.;

(c) deduct the result from the actual profit of 1914–15.

(d) then deduct the income tax applicable;

(e) take 60 per cent. of the difference. Allow 6 per cent. on new capital.’

The estimated yield was £29½ millions for a full year. By this time details were in rapid transition and the scheme had gone to the Cabinet. My rough manuscript note of the conference with the Chancellor says ‘abolish 10 per cent. margins, and income tax deduction, and take 50 per cent.—allow £100 off all excess—6 per cent. on capital—effective capital—tax agents. Bring plus and minus excesses up to date because of different years—include controlled establishments—appeals for new capital, capital not remunerative, real war businesses’. The following Sunday I drew the first written detailed scheme, and by the 2nd October it was in its first printed proof for the Finance Bill.

The scope of the duty

Amongst those who were ultimately decided to be outside the scope of the Act were actors (but not actor managers),

assessors (for Lloyds), patent agents, consulting engineers and marine surveyors, public notaries, veterinary surgeons. In the case of businesses described as 'Auctioneers, House and Estate and Land Agents, Surveyors and Valuers' the receipts from commission on auction sales, on letting and management of property and the collection of rents, and on insurance business, and from fees for the management of estates and negotiating sales, were regarded as chargeable, and if these receipts could not be shown by separate accounts, the business became chargeable as a whole, unless it was evident that professional earnings preponderated. The exemption for husbandry was very wide, and included such a business as specialized production of carnations under glass and sale in the London wholesale market, but it did not cover cattle dealing and horse dealing not carried on as part of farming operations.

The cases of preparatory schools and sanatoria carried on for profit, where there was a strong professional element mixed with a purely business element and the employment of a large-salaried staff, presented great difficulty, but on appeal they were mainly decided to be outside the scope of the charge.

The Conception of 'Excess'—A Datum Line

The assessments to Schedule D for the income tax year 1914/15 were based, with a few exceptions, upon the average of the three trading years ending on or before the 31st March 1914. In perhaps the majority of instances the actual calendar years 1911, 1912, and 1913 had been taken as the basis.¹ This assessment was, on the whole, the highest that industry had known, for 1912 and 1913 were boom years, although of course in individual businesses and particular industries it might be shown that this was not the case. The total assessments to Schedule D for 1914/15 amounted to £724.5 millions as compared with £670.6 millions for 1913/14 and £628.6 millions for 1912/13. The actual aggregate profits for the individual years 1912 and 1913 and 1914 were in the ratio 100 : 108 : 94. It was perfectly natural, therefore, for the assessment 1913/14 to be

¹ My investigations led to the conclusion that about 50 per cent. of businesses make up accounts to 31st December (*British Incomes*, p. 177).

suggested as a suitable 'datum line', to use an expression which was early employed and obtained universal acceptance. It seemed indeed to be a true 'datum' and to provide a ready-made starting-point which would require no adjustment. But when the tax came to be elaborated it was soon found that no ready-made figure existed which could be adopted without any modification whatever. The Income Tax Schedule D was a legal conception, or a mere artificial section of 'profits' in a business sense. The Schedule D assessment excluded that part of the return upon capital which was assignable to the annual or rental value of premises owned by and occupied for the business. It is true that if this remained constant each year, and the profit in the war years also excluded this element, and the principle of comparing 'like with like'—to use another term that soon became current—were maintained, no difficulty would have been raised. But the use, in some instances, of a 'percentage standard' on capital would have necessitated a computation being made as to the amount of capital which should be excluded from the comparison because it was assignable to the value of the property.

The Schedule A, or annual value, was a known and indisputable figure, but the capital 'employed' in the building was frequently unknown, and its determination would have given rise to a difficult local problem which might have delayed the assessment and collection of the duty indefinitely. As a practical course, therefore, it was decided to restore to the category of 'profits' this element which had been assigned for income tax purposes to 'property', and by the addition of the Schedule A value to the Schedule D profit to obtain a comprehensive commercial aggregate of profits. The second defect arose from the fact that assessments to income tax frequently include sums which are not income to the actual person assessed. He pays the tax virtually as collecting agent for the revenue and deducts an appropriate amount or proportion from any loan interest or ground rent payable by him. Apart from the system of 'collection at the source' and viewing them in a commercial sense, such payments are business expenses, which fall to be deducted from profits, so that a definite adjustment in the Schedule D assessment was necessary in computing profits for excess profits duty.

This involved a consequential exclusion of loan capital from the 'capital' adopted for excess profits duty, in order that the comparability of the standard and the war period profits might be maintained. Indeed it may even be said that the decision to exclude loan capital from capital for excess profits duty was the primary decision, and that the exclusion of interest from profits was consequential thereon. There have never been wanting those who thought this principle wrong, and who contended that the whole 'capital employed' should be the logical basis without regard to its objective ownership. The difference in the effect may be best seen in an example: Assume that A has £50,000 of personal capital and £150,000 of borrowed capital, that the rate of interest paid is 6 per cent. and that his total profits are £22,000, the statutory percentage being 9 per cent. Under the actual method adopted by the Statute the 'excess' chargeable would be arrived at thus:

	£
Profits	22,000
Less Interest paid, 6 per cent. on £150,000	9,000
Net	13,000
Standard £50,000 at 9 per cent.	4,500
Excess	8,500

but under the alternative scheme it would be:

	£
Profits	22,000
Less 9 per cent. on £200,000	18,000
Excess	4,000

The taxpayer would always gain the duty upon the amount represented by the difference between the statutory percentage on the loan and the actual interest on it (i.e. 3 per cent. on £150,000 in this case, or £4,500). It was urged that the true allowance on capital must be invariable, and pay no regard to whether it was borrowed or not, and that the payment of a lower rate of interest on a part of the business capital with a prime security threw a higher rate of risk upon the balance of the capital which entitled the owner to any such advantages as those indicated above. In other words, the competitive remuneration for two blocks of capital would be equal (*ceteris paribus*), and the

risks should not cease to be equally recognized merely because the risk existing over one block had been shifted *inter se*. Some businesses which were carried on almost entirely on borrowed money had practically no standard if there were no pre-war profits. While this point of view was without doubt pertinent, it should be remembered that the position of capital and interest in the original conception of the scheme was not nearly as important as it afterwards became. The main comparison was one of profits which had been so good that only a small proportion of cases were expected to require the adoption of a percentage standard, and such a standard made no pretence of putting the taxpayer in as favourable a position as if he had been prosperous—it was merely a minimum protection against hard cases, or a kind of bulwark. New businesses were not, at that time, numerous, and the importance of this capital feature was not apparent. The comparison between pre-war capital and the later capital employed became subsequently of far greater importance than had been anticipated. The great rise in prices necessitated the employment of much larger amounts of working capital, and the allowances for increased capital became, in many cases, of greater importance, both absolutely and relatively, than the pre-war standard of profits itself. If the alternative course of including borrowed money as capital had been adopted, there would have been considerable disparity between the tax borne by different companies according to the dates at which their debentures or loans had been created, and to the several rates of interest paid, although the actual profits accruing to the owners of the businesses were identical. Moreover, the difficulty of drawing a line across what is almost an unbroken gradation of cases extending from money borrowed as a permanent feature of a business, through different types of short borrowing, down to ordinary bank overdrafts, would have given rise to certain anomalies in practice which could not fail to have prejudiced the course taken. Either way presented certain difficulties, but the course of allowing interest to be treated as a business expense, and confining statutory allowances to fluctuations in the proprietors' capital, was certainly simple and straightforward, and was justified in its results. The alternative would of course have

had greatly enforced cogency in a permanent duty with a general interest standard.¹

Yet another reason existed why the adoption of the simple comparison of Schedule D assessments in pre-war and war years was impracticable. Just as Schedule A and Schedule D made for taxation purposes an arbitrary division of commercial profits, so, frequently, such profits were divided between Schedule D and Schedule E in a manner which would have given rise to great inequalities in the incidence of an excess profits duty. Where a private limited company is in the ownership of one or several people working therein, the proportion of the profits which shall be assignable as remuneration for services is almost arbitrary, and whether the owner-manager receives the profits as salary and commission or as dividends is of small consequence. The assessment of such salaries under Schedule E instead of Schedule D is a satisfactory device for income tax, but if Schedule D were taken as the sole test of profits for excess profits duty, the mere device of assigning an increasing sum to salary, and thus diminishing the amount of the Schedule D assessment *pro tanto*, would have been sufficient to reduce the liability to the new duty in a most arbitrary manner, and in a way which would have been very unjust to a similar concern remaining in private ownership. In the case of a private person or firm, the Schedule D assessment on profits is inclusive of any drawings or salaries paid to the proprietors or partners. Hence it was necessary to modify the amount of the Schedule D assessment in certain cases for this third reason.

But none of the foregoing reasons was actually responsible for the standard finally taken. The various deputations that waited upon Mr. McKenna to represent various interests nearly always laid stress upon the fact that the proposed standard included some untoward feature which depressed the profits of one of the pre-war years, and they called for a reinstatement in some way of the profits so lost. The Dublin strike of 1912 was a particular instance, and it was, perhaps, this case that finally determined Mr. McKenna to allow each business to choose the

¹ The important difficulties that arose in connexion with this method in Banking are rather too technical for this volume.

best two out of three pre-war years. This decision obviated the necessity for a detailed examination of each particular grievance and for the reinstatement of the profits affected. It furthermore made a recourse to the percentage standard based upon capital necessary in far fewer cases. As it gave, in most cases, a standard composed of the two best years ever experienced, it had the effect of postponing to a comparatively late date any general complaint as to the inadequacy of the standard arising from its lower real value, or purchasing power. The effect of the change was probably to raise the aggregate effective standard for the first accounting period by 15 per cent.

Abnormal Depression in Pre-war Years

There were not wanting various businesses that had not shared the general prosperity of 1911 to 1913. It is inevitable that there should be some declining businesses in every trade, and indeed some whole trades whose prosperity moves in cycles of longer periods than three years. It was decided to provide what came to be known as an 'abnormal depression' standard which recognized a real change of circumstances taking place within six years. When the profits of the second half of that period were substantially (25 per cent.) less than those of the first half, a choice of four out of six years was given. Recourse to this standard was not on any considerable scale, but it sufficed to make provision for a number of claimants who might otherwise have been exceedingly vocal, and whose cases would have prejudiced the initial acceptance of the scheme.

There was an element of retributive justice about the use of the income tax results for the standard, and not a few who had pressed hard and successfully in pre-war years for particular reductions of profits for income tax, lived to regret their skill and enterprise when they found that, in getting the profits so reduced as a standard, they had adversely affected their liability to excess profits duty for a number of years. There was an occasional claim, therefore, for what had seemed to be a boon in 1913 to be withdrawn, and expenses then claimed to be reinstated as profits.

One business in particular had been most pertinacious in

pressing its appeal in 1912 to have a certain large and exceptional expense which the Inland Revenue regarded as a capital loss treated as a trading expense in that year. After a preliminary bout the department with some reluctance gave in. In 1916 the owners, finding their profits standard much lower than it might otherwise have been, in consequence, then urged that the defeated contention of the Revenue should prevail, and that the expense should be added back to profits. In a number of cases where Schedule D assessments in pre-war years had been acquiesced in by the taxpayer, increases were pleaded for on account of the new duty, which would probably never otherwise have been urged.

The New Importance of the Time Element in Accountancy

The new form of taxation threw into very prominent relief an aspect of exact accountancy to which close attention had previously been hardly necessary, viz. the *precise* determination of the profits of a particular year. For income tax purposes, with a system of averages, and no great variation in the effective rate of tax, it was often not very material whether a particular expense was assigned to one year or to another, nor did it matter greatly how profits might be allocated in point of time. But when particular years were chosen for a standard, and a tax at very high rates was being substantially varied between different accounting periods, it was no longer true that it would be 'all the same in the long run'. The assignment of the charge for a bad debt, for example, to a particular year upon some definite principle, might become a matter of great importance. If it were thrown into a pre-war year it might depress the pre-war standard, which, coming into effective operation in every accounting period, would thus affect the amount of duty payable to an extent far greater than the actual amount of the debt itself. Such a question as a debt or contract claim subject to lengthy legal proceedings gave rise, especially after varying fortunes of success and failure in successive courts, to difficult questions as to the date at which the final result should be deemed to be effective. It should be remembered that ordinary prudential considerations, which induce traders to make provision for

contingencies, are carried out on such arbitrary and personal lines, and with such differences between various businesses, that the actual course followed in the accounts could never have been taken as the test in determining liability to a heavy tax. There is, of course, some presumption in favour of the course actually followed, but only if it had been adopted before any knowledge of the effect upon taxation could possibly have been foreseen. The method of 'spreading' the profits upon contracts covering long periods of time, such as those for shipbuilding, became of unusual significance, and the special problems of the war itself, such as enemy debts and suspended payments generally, became the subject of scrutiny in the light of exact accounting principles. Two opposing views may be noted. In the first, it was held that the 'profits of a year' could never be truly known until some indefinite date after its close, when every transaction entered upon in that year had worked itself out to a final and definite issue. Under this principle the profits of 1915 could not be definitely stated until every debt incurred in that year had proved itself good or bad, and this might have involved a delay of a considerable period. Under the other principle it was recognized that the process of trade is an indestructible continuity. Across this continuum, at a date which, though regular, was arbitrary in relation to the trade, a line was cut, which involved a definite valuation of every outstanding or uncompleted element in the continuum, in the light of the best facts or expectations in the possession of the trader *at that date*, in much the same way as if the business were to be the subject of purchase consideration for a capital transaction at the date. It was an instantaneous photograph of an object in motion. Abstract theory as well as practical convenience led to most questions being settled in the light of the latter rather than the former principle. Provision upon merely prudential lines, however praiseworthy on other grounds, became of doubtful value, and indeed, a little suspect in the light of the effects on war-time taxation. In every debate, however, in successive years proposals were put forward for allowances to be made based upon the action that the 'prudent trader' might see fit to take, which displayed a touching faith that 'prudence' was absolute in

character, and would remain uninfluenced by surroundings, in the hands of a legion of traders all qualified to supersede St. Anthony.

One of the great features of the duty was the fact that, owing to the taxpayer wanting his profits stated as high as possible in the pre-war years, and as low as possible in the war years, or in the war years subject to the highest rates of duty, the interests of taxpayers as a whole were rarely identical, and were scarcely ever opposed to the Revenue as a whole. The Crown Surveyor found frequently that a given principle was being violently advocated by one taxpayer, and as vigorously opposed by another, because in the one case it affected a pre-war year and in the other an accounting period.

The true ascertainment of the profits of a fixed period found its *experimentum crucis* in the valuation of stock remaining upon hand at the end of a trading year. In this matter current practices had followed prudential considerations in very varying but often extreme forms. The net effect of these practices was to minimize the profits in times of rising prices, and maximize those of times of falling prices, and to act generally as an equalizer, or compensating balance, in a way that tended to defeat the whole objects of a duty formed for a limited and exceptional period. This feature became of such importance towards the end of the war that it must be further dealt with at great length hereafter.

The Period of Charge—‘Retrospective Taxation’ Accountancy Problems

Public debate raged fiercely around the so-called retrospective charge, or the taxation of pre-war profits. The first chargeable period was the first period of account which *ended* after the outbreak of war, no matter how large a proportion of that account fell before the war. Thus an account for the year ending the 31st July 1914 was not chargeable to tax, but could form part of the pre-war standard, whereas an account for the year ending 10th August 1914 was chargeable in full. If the account had been made up for six months to the 10th August 1914, then that period was the first accounting period, and the three pre-war years ran up to the 10th February 1914. The Act did not contemplate any

apportionment of profits between war and pre-war months—it regarded the actual period for making up an account as the smallest business unit of time, the period between two stock-takings. Such a period for many businesses is really indivisible, for a precise division would have required not only an exact knowledge of turnover, with the rate of profit or loss at each stage over the period, but also a retrospective knowledge of the year's stock, with not only its quantity but also its quality and value at the prior date, the value of debts and contingent risk as at a long prior date, uncoloured by later knowledge. It was no more possible to undertake this operation properly at the later date in relation to a date two years previously than it was to photograph an event which happened at that time. All that could have been done would be to make a sketch from memory, variable according to the inclination or interest of the artist. Not only was any attempt at apportionment outside the principle of the duty, but it would have given rise to great administrative difficulties in carrying it out, and would thus have resulted in inequality between taxpayers.

In the ardour of debate an accountant member urged that it was quite simple to apportion profits; any competent accountant could do it by reference to comparative turnover. But such a view never had any wide currency.

Some few firms may have struck an accurate balance with a proper stock-taking for their own information at the outbreak of war, and were in a position to produce proof of the accuracy of accounts at that date, but the majority did not do so, and were not in a position to produce proofs. They would, however, at once have been tempted to make estimates—including an estimated valuation of stock the data for which would no longer be available—and to press them on the Commissioners, who, whether they accepted them or not, would have no adequate means of testing them. One member said in debate:

‘Balance sheets which are made up after the Government announced this taxation would be very different from the balance sheets made up before. The House will recognize that fact. There will be a new sort of balance sheet made up under the advice of lawyers or experts in this country.’

The principle tacitly assumed was that the standard rate of profit continued to be made up to the 4th August, and that, in consequence, whatever excess or deficiency was shown on the complete account must have arisen after that date. In so far as this was accurate, the grievance that pre-war profits were differentially burdened was not theoretically sound. Generally speaking of course, as the standard was based upon two picked years and trade had begun to decline sensibly after the end of 1913, the standard profit was probably in excess of the actual profit being made during the pre-war portion of the first accounting period. Thus in the case of the first accounting period ending on the 31st December 1914, with seven pre-war and five war months, if the standard was £12,000 and the *rate* of profit up to the outbreak of war £9,000 and £18,000 after, or £12,750 for the year, a true apportionment would produce an excess to December of £2,500 (five months profit of £7,500 less five months standard at £5,000), whereas by taking the year as a whole the excess was £750 only. On the whole, therefore, there was a boon rather than a hardship to the taxpayer. Nevertheless, the taxpayers brought to light a considerable number of half-yearly accounts, lying, so to speak, dormant in the books, and one of the earliest problems was the determination as to whether these cases—varying from fully executed determinations of profits down to mere shadowy estimations—were ‘accounts made up’ within the meaning of the statute. It was obviously easier for the taxpayer to bring these to light when the division benefited him than for the Revenue to discover their existence when they were against him. In the ‘hard cases’ where accounts were made up for the year to the 31st August 1914 or the 30th September 1914, much ingenuity was spent in making up interim accounts retrospectively two years later, showing that such accounts were original; some attempts reached the High Court, but with little success for the taxpayer. In the following year’s Bill a declaratory clause made it clear that if the books had been actually made up for an interim period in such a way that the profits could be ‘readily ascertained’ the period could be recognized notwithstanding that the accounts were not ‘issued’. In such industries as the woollen and worsted, when the first half-year

was reputed to show a falling off, the charge for the whole year including pre-war months 'watered down' the excess profits made during the last part.

In Parliament the principle was briskly challenged as 'un-constitutional' in being retrospective, and as 'unfair' since the duty was alleged to be intended to tax *war* profits. Some wished to apportion the first composite period, and others wished to start the duty with the first period *commencing* after war began. It was urged in reply that the true principle sought to charge all excess profit, to whatever cause due, arising *after* the 4th August, and that it was only on the final closing of an account that profit really was available. It was also upheld on grounds of practicability, but perhaps the most important factor in carrying the day for the Government's view was the undertaking, half specific and half vaguely given, that such anomalies would 'come out right in the end'; that those who came into the range of the duty earliest might expect to get out earliest, and that in general there would be equality of treatment. Mr. Montagu said: 'It is hoped by subsequent legislation to extend the tax over the whole period of the war. Therefore when we come to the end of the war—when we come to the last accounting period, which contains a peace element and a war element—the differences depending upon the different dates on which firms make up their books will equalize themselves at the end of the war, exactly in the same way in which they are unequal at the commencement of the war.' As time went on there was some doubt in many minds as to how these promises could possibly be met, but in the end they were redeemed with far greater precision and faithfulness than is common with long distance ministerial undertakings, for the whole period of charge was finally arranged to be eighty-four months or seven complete years, ending on different dates for different businesses, according to the beginning of the first accounting period. Moreover, the difficulty that seemed likely to be insuperable, owing to the changes in the rate of duty coming at a *fixed* date for all instead of at a *corresponding* date in the record of each, was overcome by a happy accident. It seemed quite unlikely that, even if the length of the total periods of charge were made the same, the average rate of duty

in force over all those total periods ending at different dates could be the same. But every taxpayer had his own first year at 50 per cent. and later on had two fixed years, 1917 and 1918, at 80 per cent. and 1919 at 40 per cent. It was the period of variable lengths between the end of the 50 per cent. period and the 1st January 1917 that was charged at 60 per cent. Fortunately, at any rate on this point, the duty at the end was 60 per cent. and by the seven-year arrangement, after deducting the four periods charged at 50, 80, and 40 per cent., the residuum charged at 60 per cent.—either at its first or at its last imposition—was necessarily the same in all cases. Of course, this did not mean that the seven-year aggregation of profits would bear the same total duty, irrespective of the periods in the seven years when profits might have been made.

Another point arising on the difficulties of the opening accountancy period may be briefly noted. Although the Government were prepared to bring under charge, if necessary, practically a whole year of pre-war profits, in no case did they work to go beyond this point. Where accounts had not been made up throughout a long period, greater than a year, 'splitting' was allowed, and it was almost invariable that profits were assigned on a *pro rata* basis. The commonest cases were shipping 'voyage' accounts. As a general rule, if such an account began after 4th August 1913, e.g. from 30th September 1913 to 31st March 1915, it was divided at 30th September 1914, and the *whole* of it became chargeable. But if it began prior to August 1913 (e.g. 18 months from 31st March 1913 to 30th September 1914) the exclusion of some portion was necessary, and the previous record was taken into account; if accounts had run regularly to 31st March, then the year 31st March 1914 was taken as a pre-war year, and the first accounting period made the six months to 31st September 1914. But if a permanent change had been made to September for making up accounts, then the *year* to 31st September 1914 became the first period.

Apart from the fact that the rates of duty in different periods differed very widely, there would not have been very much point in excessive carefulness to assign particular items of profit or loss falling within the whole period of the duty to one precise

accountancy section of that period. But with a duty ranging from 80 per cent. to 40 per cent. it meant that the writing off of a particular bad debt of £100 in one year instead of the next would cost the Government £80 instead of £40, or that to assign a proportion of a partly finished contract on one basis instead of another to a period when the duty was high would make a material difference to both sides.

If the taxpayer knew, before the closing of his account for a particular date, what the charge would be for the period following, there was every inducement to him to take such a view of a matter, for which no precise accounting practice or procedure existed, as would best suit his pocket. But the confident anticipation of repeal when the accounts for 1919 were being made up led many astray, for they loaded up that year with every expense that could be justified, and put forward every gain where such postponement was plausibly defensible, only to find later when the year 1920 came under a 60 per cent. duty that they had exercised their judgement in both matters so as to starve 1920 of expenses and load it with taxable profits.

Dr. Haig said that the British plan of allocation of profits on long contracts was more liberal than the American, under which the income was distributed in proportion to the expenses incurred in each year. Their method 'has arbitrarily allocated profits on long-term contracts to the years in which our tax rates were highest, since the cost of labour and material were extremely high in the same years'.

It was the fact that human judgement is so susceptible of leading by its interest that made it necessary for officials to impress upon Ministers continually that any change made must operate from a date *prior* to the announcement. 'Forewarned is forestalled.' 'In vain is the net spread in the sight of any bird.'

Apart from these internal 'strains' set up by different rates of duty, the period of charge was virtually one period, successive accounts being 'linked up' by the 'setting off' of deficiencies. The Revenue officials had often only a general idea of the amount of the pre-war standard and of subsequent profits—looked at broadly it could be seen that the results of 'deficiency' periods would outweigh the results of 'excess profit' periods, so that no

good purpose was served by making any precise calculations where no payment of duty would result.

In a number of cases only in the seventh year of the duty was any prospect of net liability discernible, and therefore it was then necessary to work out the precise liability for each of those seven years. It would often happen at the end of that laborious task, with much going back into old facts and figures, and remote causes and intentions, that no final liability would emerge after all.

The systems in the Dominions, based upon our model, took the same view of the separate accounting periods, but as regards the United States, as Dr. Haig has said:

‘The Statute adhered very closely to the conception of *annual* gain. Each twelve-month period has been forced to stand by itself, a heavy profit being taxed in the year received, taxed, too, at progressive rates and no adjustment permitted because of a heavy loss occurring perhaps the following year. Minor exceptions to this statement are the special relief provisions of the Revenue Act of 1918 which permitted net losses for the year 1919 to be charged back to 1918 and forward to 1919 if the taxable year chanced to begin between certain dates and which permitted rebates in the case of inventory shrinkages under certain narrowly-defined and even more narrowly-administered restrictions. In contrast with this, the British from the very beginning practically ignored for this purpose the arbitrary closing dates of accounting periods and freely allowed the rebate of Excess Profits Duty collected in time of prosperity whenever such periods were followed by depressions.’

He concludes that in the United States they have undoubtedly levied heavy taxes upon a large amount of profits which consist merely of the increased values of inventories, and have made practically no provision for returning these taxes in case the profits prove illusory because of a reverse movement of prices. Their general conception of the accounting period practically insulated each year’s trading from every other, and Dr. Haig advised his Government to abandon their comparatively narrow conception of the accounting period. ‘If we are wise, we will copy the British practice with respect to this. The problem is as significant for income taxation as for profits taxation, and is one which will be particularly important in the period of falling prices upon which, apparently, we are now entering. In effect, we decline to regard business as a continuing operation.’

The Percentage Standard

The broad principle underlying the provision granting a percentage standard as an alternative datum line was that, if no more favourable standard is available to the proprietor of the business by reference to the amount of his past profits, his excess profits may be reckoned from the starting-point of a fair return on the capital which he had at stake in the business.

Investments outside the business (the income from which was excluded from the profits of the chargeable period), borrowed capital (the interest on which was similarly excluded), and debts due by the business had, of course, to be excluded. None of these elements could be regarded as proprietors' capital at stake *in* the business, and the inclusion of any of them would merely have resulted in a comparison of unlike quantities.

No effective direct method could be devised for ascertaining the amount of the proprietors' capital actually at stake in the business, except that of first finding the total capital of the business in the broad sense and then making proper deductions for investments, borrowed money, &c., from the amount so found. Consequently the proprietors' capital at stake was reached in two stages:

- (1) The total capital of the trade or business, in the broadest sense, was first found.
- (2) The elements above mentioned were eliminated.

Under (1) the capital could be looked at from two points of view: (*a*) the total money put in, or (*b*) the value of the assets. The value of the assets could also be looked at from two points of view: (1) cost price and the extent to which the amount representing the cost price had disappeared by wear and tear; (2) present market value.

The total money put in would not have reflected the gross capital at stake, for the money might have been squandered or misappropriated. Again, the then market value of the assets would not reflect that capital, for, in so far as that market value could be ascertained (and the valuation would have been one of great difficulty), it depended in general on the profit-earning

capacity of the asset at the time, and a fair return thereon would thus have been liable to yield a result equivalent to the amount of the actual profits at the time, and form no effective substitute for the profits standard. The method adopted—and, as it seems in the result, the only sound method—was that of reckoning the assets, still in use in the business, at cost price, reduced (in the case of assets suffering in profit-earning capacity either by exhaustion of power or increasing need of repairs) according to the amount of the 'life' that had expired. If provision had been made for replacement of the asset when exhausted, such provision came into the total assets of the trade or business, but if not, it was evident that by wear and tear the original capital was being used up and part of the cost-value had been consumed along with profits in the past.

If the assets had been acquired otherwise than by purchase, their value at the time of acquisition by the business (reduced as above) was reckoned as their value.

Debts due to the taxpayer were taken at their face value except that if any sum had been claimed and allowed for bad debts for income tax purposes, the face value was correspondingly reduced.

Under (2) provision was made for a deduction from the figure under (1) for those elements which did not constitute proprietors' capital at stake *in* the business, viz.

- (a) capital invested outside the business,
- (b) borrowed money,
- (c) debts due by the business.

A third provision was made for the case where an asset had been paid for, not in cash, but by an issue of shares; it was provided that the real value of the consideration, not the nominal value of the shares, should be taken as the cost of the asset. It is, of course, of common occurrence (more especially in connexion with the flotation of private companies) that the market value of shares issued differs entirely from their nominal value, and where such shares are allotted as consideration for the acquisition of an asset it is the market value of the shares which represents the true amount of the consideration paid.

Where the owner of a private business had converted it into

a company, and was himself allotted the whole or main part of the shares in consideration for the assets, including goodwill (upon which he had spent nothing), the value set upon such goodwill, or other non-material assets, would be eliminated. If this course had not been taken, an arbitrary or inflated valuation of intangible assets, made by its owner and not brought to the test of fact (as, for example, by a public subscription for shares with a view to its acquisition), would have been treated as part of the proprietor's capital at stake in the business and claimed as part of the sum on which the percentage standard was calculated.

The cardinal principle was that wherever goodwill had been really bought and paid for the capital sum was intended to be recognized, just as was done in connexion with any other asset. Obviously, however, a private trader could not include goodwill, upon which he had spent nothing, as part of his capital at stake. Amendments were proposed to deal with goodwill acquired by a private company on the conversion of a private business into such a company, and belonging in name to that company, but in substance still the property of the vendor as the principal shareholder. The fact that a private trader had converted himself into a company, himself taking all the shares, did not, however, constitute a good ground for taking into account the goodwill, for which, if he had remained a private trader, credit could clearly not have been given. Where such a vendor had sold goodwill (upon which he had spent nothing) to a company which was virtually himself and had received payment in shares, the value set upon the goodwill was to be eliminated, so that an arbitrary or inflated valuation of an intangible asset, which had not been brought to the test of facts, might not affect the pre-war standard. The rule was restricted to the case of the conversion of a private business into a company, the shares of which were wholly or mainly allotted to the vendor, and still remained in his hands. In practice some very subtle distinctions had to be drawn for partial reconstructions where a proportion only of the ownership had changed. After the initial tussles, this general conception of capital gained full acceptance. But there were difficulties in computing banking capital, insurance capital, and also the

accretions to capital through accumulating and accumulated profits. Dr. Haig said, on the general subject:

‘The British concept of invested capital tends to be more a “current capital” concept than ours. Although neither they nor we reappraise assets periodically during their life, they tend to approach more closely the value of the assets actually at work during the current accounting period.

‘This distinction must not be over-emphasized, however. In fact, the number of American corporations which benefit by virtue of it is undoubtedly small. In the absence of full allowances for net losses from period to period such relief is probably justified. Dr. Plein¹ took a different view but he appears to have been led astray by the fact that the English percentage standard is established by applying the statutory percentage to the invested capital as it stood at the end of the last pre-war year. As a matter of fact the modifications permitted because of increases or decreases in invested capital after that date took into account with absolute exactness the subsequent variations in capital even though those modifications were made in the profits of the current year rather than in the invested capital itself.’

The concept of invested capital in both countries excluded unrealized appreciations. The starting-point with us was the original value of the asset invested in the enterprise, from which value we made deductions for losses and wear and tear, and to which value we, in effect, made adjustments for increases and decreases in capital invested. The operation was concerned with the asset side of the balance sheet. In America, on the other hand, they dealt primarily with the liability side of the balance sheet, making various alterations necessary as a result of a scrutiny of the assets. They began with the outstanding capital stock, and in so far as it represented cash or assets actually put into the enterprise it was accepted as invested capital with certain limitations.

The general effect of the capital standard and allowances in the British tax was to relieve the particular hardships of a straightforward comparison of mere profits. But it was not so in the United States to a like extent. Dr. Haig said:

‘While we in America used one invested capital standard in 1917, adopted an alternative profits or invested capital standard for 1918 and

¹ In his article entitled ‘War Profits and Excess Profits Taxes’ in the *American Economic Review* for June 1920 (pp. 283–98).

abandoned the profits standard in 1919, the British have held to their original arrangement, the only important modification being a change of percentages used in establishing the standard based on invested capital. While we change the application of our statute from extreme broadness to extreme narrowness, the application of the British Duty has remained the same. While we have made sweeping changes in our definition of taxable profits and invested capital, the British have made only minor alterations. This stability has undoubtedly been a factor in the success of the British administration.

‘In comparison with the American law, the most impressive features of the British statute, aside from its comparative stability, are the remarkable care which is taken to alleviate cases of unusual hardship, the wide scope given to the administrative authorities in making adjustments and the full provision made for appeals to bodies outside the courts of law.’

Administrative Machinery: The Board of Referees

The Board of Referees represented a bold experiment. It was clear in a very general way that if a flat percentage were taken as applicable to ordinary business there must be some businesses in which the capital was subject to special incidents to which particular consideration should be given. Such consideration should entail careful examination and be settled on uniform lines, with the preparation of statistics and the hearing of evidence by persons sufficiently experienced in general business to appreciate the issues involved. It was a task for which the House of Commons itself was quite unsuited. The delegation of the power of taxation by Parliament to any other body outside itself was an important constitutional development, for the Board of Referees would not, like an ordinary Court, have to decide points of law, nor, like an ordinary body of appeal commissioners, have to decide individual questions of fact, but they would have to put forward a figure akin to a rate of tax in its effect, which would be substituted for a figure given in the Act, and be applied to unknown classes of people and to unknown numbers in those classes. This delegation of power was limited in certain important ways which had their constitutional aspects. First, the maximum tax that could fall upon the subject was fixed in the Act, and any action by the Referees could not *increase* the taxation of the subject, but would mitigate the burden imposed by Parliament. If this had not been the case it would

have been an indirect breach of the constitutional rule as an imposition of tax without a resolution of the House, and also as being an increase of a duty by some person outside the Government.¹

In the second place, it was not competent for the Board of Referees to single out individuals for treatment or even to hear their applications for the purpose of granting special percentage rates. The statutory admission of such a claim would certainly have been tantamount to a cession of taxation powers to a body not responsible to Parliament. It was necessary for applications to be presented by a 'class of trade or business' and for any ruling to be applied, without option, to all individual businesses which came within the class limits defined. The only matters verging upon an exception to this rule related to 'munition' concerns which were presumed in peace-time to have relatively low profits, waiting until the orders of war-time should provide the financial justification for their existence. But even here the exception was more apparent than real. The concerns in question coming within the statutory definition could not be numerous. It was impossible for the statute to provide rules for dealing with them in anticipation of a proper examination, and if they were left to be dealt with by the ordinary appeal jurisdiction of the District Commissioners of Income Tax it would be quite unlikely that any kind of uniformity in their treatment could be evolved. Despite the fact that each business would be treated separately, they

¹ This, though generally correct as to the consequence of the decision of the Board of Referees, was not necessarily so. For example, A. B. might be one of the less fortunate members of a class of business to which, on the representation of a majority, a higher percentage rate had been granted, say 12 per cent. instead of 6 per cent. Under the ordinary operation of the Statute the following hypothetical computation of duty is taken:

	£
Profits of Accounting Period	10,000
Profits standard	<u>11,000</u>
Deficiency:	1,000
<i>Add:</i>	
6 per cent. on decreased capital	<u>800</u>
<i>Net Deficiency:</i>	<u>200</u>

After the decision of the Board of Referees the addition for decreased capital would be £1,600 (at 12 per cent.) and there would be a net excess of £600 chargeable to duty, so that what was given as a boon to the majority might increase the burden upon individual taxpayers.

would appear before a Central Board of Referees as a *class* of business, to which consistent principles would naturally be applied. As a matter of fact these war-time businesses were the original *raison d'être* of the appointment of a Board of Referees. In his earliest introduction of the duty in the Budget Speech of the 21st September 1915, Mr. McKenna makes no mention of increasing the percentages for classes of business, but only of these special war-time businesses that were essentially sub-normal in peace.

Members soon wanted information about this novel tribunal. They urged that it should deal with 'difficult cases' and in his initial reply the Chancellor went a long way towards this snare: 'Of course if there are any special circumstances in cases of individual firms we shall be quite reasonable, and such cases will be dealt with by the tribunal which we are proposing to set up.' But the Chancellor had his warning in time and when the Bill appeared, and was discussed in Committee, the constitutional danger had been successfully averted, for the words 'class of trade or business' appeared therein. The debate on the clause ranged round two distinct points. There was an undoubted, if unjustified, fear that the Board of Inland Revenue would prevent free access by the taxpayer to the new tribunal. The condition that a *prima facie* case must be made out to Somerset House was accordingly withdrawn, and in its place the Inland Revenue had power to keep back 'frivolous and vexatious' applications. It was thought that an insignificant or hare-brained individual might, by premature application, prejudice the case for a whole class, and it was also desired to prevent the Referees from being 'snowed under'. Then there was the resolute attempt, to which a return was made in subsequent years, to secure individual access to the Board. There is no doubt whatever that subsequent experience proved these points to be of greater constitutional significance than was suspected at the time.

The power was given to the Board to deal with applications for a calculation of the percentage standard 'by reference to some factor other than the capital of the trade, or some additional factor when the amount of capital actually employed is, owing to the nature of the trade or business, small compared

with the capital necessarily at stake for that trade or business'. The actual case giving rise to this provision was that of marine underwriting, but the administration were continually alive to the necessity for keeping all mention of specific trades with special treatment for them out of the Act; for otherwise, with such a precedent once admitted, an epidemic of particular clauses might have ensued. General words were therefore drawn which should meet the case in question without being wide enough to admit others. Similar precautions were taken in other clauses in regard to Banks and Shipping, which were not, however, mentioned.

There is no doubt whatever that the psychological effect of the existence of the provision with regard to the Referees was a most important factor in the reception of the duty. It is human nature for each taxpayer to regard his own case as *sui generis*, and it was recognized by slow degrees at a later date in practical working that the individual appeal did not exist. For some time quite a large proportion of the people *prima facie* liable to the duty anticipated that the strict terms of the statute would be modified in their own cases because of their 'exceptional' circumstances. No kind of uniformity emerged from the various principles upon which these expectations were based, indeed they were often mutually contradictory. It was thought by some that if a comparatively low rate of profit could be shown to have existed in a trade prior to the war, that fact of itself would be a strong ground for getting a higher percentage than the statutory rate. On the other hand, members of trades which had enjoyed a high rate of profit thought that 6 per cent. would be an absurd rate to apply in their case. Although the Board never published any reasons for their rulings, and merely confined their decisions to the announcement of a rate per cent. or a refusal to increase the statutory percentage, the principles involved soon began to be known generally by the small group of solicitors and counsel to whom would-be applicants had recourse and who became specialists in this class of application. In the preliminary discussions with applicants the Revenue officials made no secret of the principles which, in their judgement, had been in the minds of the Referees in previous cases, and in the interlocutory

hearings they were again referred to, while the expression of the departmental point of view at the hearings also led to a general body of doctrine being built up which became common knowledge. Thousands of potential applicants were thus weeded out, without any kind of real resentment growing up against the Board for disappointing such widespread hopes.

Dr. Haig said: 'To complain about an award, when the proceedings are conducted essentially as an arbitration, is considered to be very "bad form"'. The writer heard of only one case where a trader had failed to accept his decision with good grace and he was quite frankly dubbed a "poor sport" by the business man who mentioned the occurrence.'

The Referees were exceedingly fortunate in that they did not prejudice their work by any serious mistakes in principle in the early stages which might have embarrassed them later. In such a novel excursion into an unexplored economic area when the full implications and possibilities of a step in a particular direction cannot possibly be known, it would not have been surprising if the Referees had, later in the day, found it necessary to go back upon their tracks and modify the broad principles adopted at the outset. So far as the departmental view was concerned, the officials had, from the first, a fairly clear idea as to what were and what were not admissible and valid reasons for increasing the percentage and also as to the proper methods for giving quantitative expression to those views. The writer has in his possession a draft statement, dated 31st March 1916,¹ of the main grounds for such increases, and it is found that at the termination of the duty the body of practice built up by the Board of Referees differed therefrom in no material particular. The first chairman, Sir Henry Duke, though only a short time in the office owing to his transfer to Ireland, performed a valuable service when settling the form of procedure by devising the 'interlocutory hearing'. When the application in prescribed form had been lodged with Somerset House, and the Department had decided that it was neither frivolous nor vexatious nor related to a class already adjudicated, and should be sent on to the Board of Referees, an official comment upon the state-

¹ Vide Appendix III.

ments or reasons given in the application was transmitted with the application, and the applicant advised. This 'rejoinder' usually consisted of a brief note that certain statements of fact would or would not be admitted without proof, that certain principles were either admitted or would be contested. At the interlocutory hearing before the Chairman of the Board of Referees these two documents were reviewed, the definition of the class closely scrutinized, the applicants warned as to the onus of proof on particular points, arrangements made for the preparation of agreed statistical evidence on both sides, and a date for final hearing fixed sufficiently removed from the date when the documents were agreed to be exchanged for time to be available for the necessary examination by the respective sides. Not a few applications were shown at this hearing to be misconceived. The proceedings were usually reported and the printed record formed part of the papers finally considered by the Board. It is not too much to say that by this device the time the Referees might have spent was reduced by 80 per cent. and a continuous series of adjournments for each case was avoided.

After Sir Henry Duke left, Sir Charles Bine Renshaw was appointed to the Chair, assisted by Mr. (now Sir) Duncan Kerly, K.C. Sir Charles Renshaw's wide knowledge of business and his general sagacity did much to make the earlier proceedings acceptable to the public, but it is generally conceded that the firm grasp of economic principle and the avoidance of legal and statistical pitfalls which characterized the Board's decisions was due to the influence of Sir Duncan Kerly, who became Chairman upon Sir Charles Renshaw's sudden death. Sir Duncan's mathematical and scientific bent combined with his great experience at the Patent Bar made him exceptionally well fitted for the task.

The position of the Department in this matter was peculiar. Beyond the preliminary duty of protecting the Board from being flooded with redundant or frivolous applications, the Revenue officials had no standing whatever, and were simply ignored by the statute. The Act seemed to contemplate that the Referees would themselves be a court of inquiry, with statistical and economic research, and do the actual work of investigating the facts involved. But it became quickly evident that the Revenue

officials, Sir Ernest Clark and myself, and later Mr. A. C. Alcock, were not merely advocates for a Revenue view, but expositors of recognized principles, and the Board, after a time, became largely a body to confirm their findings suggested in the joint arrangement between the Revenue and the applicants.

The really critical case came early in the hearings. There was no direct statement in the statute as to the purpose which the statutory percentage was intended to serve, and neither the explicit explanation of the Chancellor nor the popular view could be brought in evidence upon it. But the Referees could take their own view upon it with whatever extraneous assistance there might be, and it would have been difficult to make a 'point of law' for the Courts if a decision on the percentage, without any reasons, were given, and the Board had had before them adequate evidence upon which to base a decision. The contention that the average pre-war profits in a trade should have direct bearing upon the percentage to be given was a very plausible one, and the application of the Paint and Varnish Industry raised the point in its direct form. There is little doubt that the decision to ignore this particular consideration, and to regard this industry and also the Hosiery manufacturing industry—the application on behalf of which was also unsuccessful—as typical ordinary industries of the country to which the Act should apply without modification, saved the Revenue some scores of millions in duty. The 'average profits' principle, once admitted, would have played havoc with the yield of the tax, for the average profits of the best two years of the pre-war boom could not well have been less than 10 to 11 per cent. over the whole country, and in many industries were, of course, far higher. As the case itself was so important, and the earlier stages of argument before the Referees are of general interest, full extracts are printed in the Appendix.

The next crucial test related to the idea of a 'class of trade or business' together with the 'subdivision of a class' referred to in the statute. It is obvious that if this had been narrowly construed it would have been possible to have given such a detached definition of a subdivision as to exclude all businesses save that of an individual applicant. Early decisions of the Board made it clear that a subdivision would be allowed by reference to geo-

graphical division or locality. Such descriptions seemed to lead direct to a subdivision by reference to the way in which a particular industry was carried on. Perhaps this was the nearest that the Board ever went to the admission of a really dangerous dichotomy. Without quoting precisely there were such subdivisions as 'the trade of bootmaking in the village of Blank in Perthshire' or 'the business of millinery carried on by ladies in shops on the south side of Piccadilly' or 'the trade of importing glassware from Belgium and selling wholesale to railway restaurant car contractors', or 'the manufacture of green bottles by the A.B.C. process'—all of which are fairly close imitations of actual applications by persons desirous of getting their individual business before the Board. Obviously a sufficient development of a 'this is the house that Jack built' method of classification would have given every business in England its individual appeal. As the Chairman once remarked, the definitions of classes lacked nothing for the purpose of identification, save a portrait of the managing director. After a number of attempts of this kind at interlocutory hearings, the Board were moved to issue a general ruling in principle.

The Board gave decisions in 176 cases under Section 42, of which 66 were for classes of business carried on in the United Kingdom, and 110 classes carried on entirely abroad (though, of course, *conducted* from this country). The commonest or 'modal' award has been $7\frac{1}{2}$ per cent., which was given in 17 'home' cases and 24 abroad, but the average for the United Kingdom, excluding 7 cases where no increase was given, was slightly under 10 per cent. and for foreign 11·3 per cent. with an overall average of 10·7 per cent.

They may be classified as follows:

Percentage granted.	'Home Cases'.	'Foreign Cases'	Total.
Av. 7 or under	10	6	16
8	17	24	41
9	10	17	27
10	2	21	23
12	8	18	26
15	7	15	22
20	1	4	5
25	1	3	4
Over 25		2	2

When classified as to classes, Mining was of course the most conspicuous:

MINING. *Overall average: 14·5 per cent.*

<i>Product.</i>	<i>Sub-Class.</i>	<i>Average Capital Percentage.</i>
Chrome Ore	2	20·0
Coal	7	9·4
Copper	4	12·5
Gold	6	21·7
Iron Ore	3	11·3
Lead, &c.	6	12·5
Antimony, &c.	6	14·0
Tin	5	19·0
Miscellaneous	4	11·2
	<u>43</u>	

OIL. 11 11·0

IRON AND STEEL INDUSTRIES, &c. *Overall average: 8·9 per cent.*

Aircraft and Motor Engineering	3	10·0
General Engineering	2	9·0
Iron and Steel Manufacture	8	9·1
Electrical Engineering and Supplies	3	6·6
	<u>16</u>	

PUBLIC SERVICES. *Overall average: 8·3 per cent.*

Tramways, Omnibuses, &c.	7	8·0
Electric Power Supply	9	8·1
Telephones	5	8·0
	<u>21</u>	

FOREIGN PRODUCE. *Overall average: 9·5 per cent.*

Sugar, Tea, and Coffee	13	9·3
Cotton	5	10·2
Miscellaneous	25	9·5
	<u>43</u>	

FOREIGN AGRICULTURE	6	10·5
CEMENT	2	8·0
NON-FERROUS METALS	3	9·0
COKE	2	8·5
CHEMICALS	4	6·2

The Board of Referees quickly won public confidence. The Chancellor paid his tribute:

‘It is only fair that our attention should be drawn to another factor which has greatly facilitated the operation of the tax. One of the elements of great doubt was the settling of disputed questions by particular trades as to what their allowances should be in the way of interest. . . . The very great ability and celerity with which that work was done far exceeded the anticipations which were formed at the time.’¹

¹ Hansard, xciii. 395-6.

Special Cases(1) *Insurance*

The difficulties in connexion with life insurance might have been much more real if liability had actually arisen as a practical matter.

Excess profits duty was designed to fall on the 'excess' profits arising from a trade or business in an accounting period, such period being not greater than a year. The practical difficulty affecting life insurance companies was due to the fact that the profit arising from the business could not be properly determined without an actuarial valuation, and such valuations are habitually made only at extended intervals, such as three or five years.

Life insurance societies, so far from making 'excess' profits, were suffering severely from heavy mortality claims and from depreciation of securities, and, in view of the allowance of such depreciation as a deduction, excess profit rarely arose. Companies conducting both life and other business were able to claim any proved deficiency on the life business as a deduction from any 'excess' profit on the other branches.

But losses of ships were very heavy and marine insurance became very active and sometimes very profitable—sometimes not.

Although underwriters' accounts are usually made up by the year, they are generally not closed until a period of two years has elapsed after the date to which they are made up. Thus an interval of two years elapses before the profits of a year can be correctly ascertained. This practical difficulty could, to some extent, be surmounted by making assessments in estimated amounts on the basis of provisional returns, and allowing the ultimate settlement of liability to remain in abeyance till the accounts were closed.

A claim was set up that underwriting profits should not be charged at all. The argument was that the profits that *might have been made*, if the Government had not entered the field and limited premiums, would have been such that excess profits duty might have been paid and the underwriters would still have been better off than they had finally proved to be under the actual arrangement.

It was also said that underwriting, if charged, should be dealt with on a special basis because of the enormous risks that had been run.

It was clear that it would have been impolitic to give specific exemption, because other classes of businesses had been affected by Government action, and this reason alone would have opened the door to many such claims.

In the original debate some special features of the new duty were well illustrated: Sir J. D. Rees urged that when the Government took over a portion of the underwriting risks they had limited the profits of underwriters, who, therefore, stood in a different position from any one else. They played an important part and played it well, and therefore discrimination should be exercised in dealing with them. It was further argued that it was unjust to tax to the *same extent* people at the two extremes—(a) those who sat and waited for the inevitable rise in price, and (b) those who could make additional profit and carry on business only by incurring great risks. The underwriter had made extra profit only by taking extra risks. On ordinary marine insurance he had long experience to guide him as to the premium, but when war risks had to be taken he had nothing to go upon. The naval position of Germany was such that he ran a very considerably increased risk. The Government entered the market and fixed a 5 per cent. level, limiting the taking of risks by the War Committees to cargoes in British vessels. Neutral vessels and their cargoes had to be covered in the open market and the underwriters filled the gap and kept commerce going. On this ground it was suggested that they should be allowed to deal with the *volume of profits*, and if 15 per cent. was the pre-war percentage of profit to premium income any excess above 15 per cent. should alone be regarded as excess profit.

Some thought that there was a case for exemption for both marine insurance companies and Lloyd's underwriters—their increased profit was the result of increased risks, whereas the shipowner got increased freights and profits without greater risks. The underwriters patriotically and courageously took great risks, and another German ship or two like the *Emden* at large might have landed them in liquidation. In view of the

additional risk, if one wanted them to continue one must not say to them: 'If disaster comes you are in liquidation, but if you happen to be successful you must part with 50 per cent. of the extra profit,' because some of them will not stay in upon those terms. It was urged that if they had had no Government interference they would have made large profits, and after payment of excess profits duty would have been better off than they are now without the tax. They had been prevented from making the undue profit of other trades, but were taxable on the same terms. 'The 6 per cent. which is allowed to traders is on capital, and I am not challenging it, but this is entirely different—we are asking for some percentages on the turnover—that is on the magnitude of the risk.' A percentage on the amount of their deposit liability was inadequate, because a man with good security could 'write' to a large amount. Competition with other countries (Holland, for example) made it necessary to treat the business equitably, or it would pass abroad.

It was pointed out that the Government scheme left the underwriters free to select their risks, and the view that the shipowners took no extra risks did not pass unchallenged.

In a printed statement of their case, the Lloyd's underwriters said, 'if it be now held that the whole of the underwriters' loss, however serious, must be borne by the underwriter, while of any profit 50 per cent. must be ceded to the State, the insurance market would be faced with a quite unreasonable business proposition.' Their proposition was that the net premium income for 1913 (or the average of any two of the years 1911, 1912, and 1913, at the option of the taxpayer) should be taken as the standard, the difference between the net premium income so shown and the net premium income for 1914 being taken as representing the 'extra risk' premium, and 15 per cent. profit allowed thereon, the sum so arrived at to be deducted from the excess profit shown in the ordinary way, over the datum line.

Most of the arguments brought forward were readily met. Each interest or industry in turn had been urging that it was more vital than others to the country's welfare, and had patriotically gone out of its way to be a credit to that pre-

eminence. Clearly, if such patriotism has actually received a cash reward, such remuneration was a fit subject for taxation.

The contention so frequently met that Government interference had already been the equivalent of a tax in its effect on profit was met on the following lines:

‘Some people seek to place the tax upon the principle that it should apply only to the excess above what would have been made in the absence of any war. Others seek to apply the tax to the profits the war would have brought about if its effects in their favour had been unhindered, and the other consequences of war moderating those effects had not existed. These measures of profit are mutually inconsistent, and both are different from the real principle of the tax, which makes a comparison of actual facts, and has no relation to what “might have been”.’

It was open to the community to expend money to minimize war risks in any way they liked—either by building more cruisers or by pooling risks at premiums under cost (to a cost equivalent to such cruisers). All its action was directed to the same end—to lose as little as possible for the nation and the individual. If Government action ‘limited premiums’ it also took the worst risks and left the underwriters with the selection. It should not be open to the latter to pick out one element of State activity and ignore the remainder. Possibly if the Government had not intervened, the bottom might have fallen out of the insurance market altogether, and so far from making further excess profit they might have made nothing at all.

A similar claim to a consideration of the ‘profit that might have been made’ could be set up by every trade that had experienced Government interference, notably dealers in sugar and the various staple articles upon which maximum prices had been set; or exporters who were limited in their action by the war trades restrictions on manufacturers of goods of which the price had been raised and consumption limited by imposition of customs or excise duties.

The real claim of the underwriters for special consideration rested upon the statement that their increased income was merely the recompense for increased risks, and therefore fell in a different category from profits due to price fluctuations or increased volumes of supplies.

The whole business of underwriting is the taking of risks.

Obviously if any capital had to be set aside from other uses to this use, it must receive the ordinary economic remuneration for its use, plus the additional remuneration to recompense the risk of its loss. But if the capital was not set aside as idle and could be employed and earn its economic return elsewhere, merely being kept as a 'backing' or credit for the purpose, the profits of underwriting were really not for the *use* of capital, but for the services of that backing, and for risk-taking upon it. Of course capital could not be ignored, because the capacity to take risks and therefore to secure the profits thereon was to some extent limited by the amount of backing available. In this way the turnover or premium income was related to capital but not otherwise.

If risk-taking were a national business, on mutual lines, premiums would, after payment for management, aggregate to a net amount equal to the pooled losses in the long run. But being divided up amongst a number, each underwriter had a risk of total loss which must be remunerated, and the aggregated premiums charged should, of course, tend to exceed the aggregated losses by the total amount necessary to recompense each member for his personal risk. If losses were suddenly doubled, and premiums were also doubled, it was obvious that that total recompense would be similar (as a net difference). It was clearly urged in 1915, however, that the capital backing required might be greater and its services must be remunerated, and—what was more important—that individual risk of loss was greater to an extent not met by the increase in premium. This was practically the whole point of the argument—that fixing a suitable premium had become a more speculative matter, and that a price attached to such action, in the absence of experience, in excess of the price of action based on experience. If the precise amount of extra loss could have been foretold, the adjustment of premiums would have been simple.

If, as a whole, the new premium income did not exceed the new losses, there was clear substance in the contention that the prizes in the lottery were being taxed so that the tickets were not worth their price and would be unsaleable, because the aggregate remaining reward was not equal to 'costs'. But if, as

a whole, premium income *had* exceeded the losses, with more than the usual aggregated remuneration for risk, it was obvious that risks were over-estimated and overpaid, and a fund of excess profit existed which could be taxed without driving the business out of existence.

This was a question of aggregated fact, and no group of single instances could settle it. But once it was ascertained that premiums, as a whole, were more than adequate, it seemed quite equitable to tax those fortunate ones whose business was so disposed that their risk-taking profits were higher than before the war.

The underwriters claimed that the premium income in excess of pre-war income represented extra risks assumed, and they claimed 15 per cent. profits thereon (regardless of whether 15 per cent. was the ratio of the old profit to the old income). In a business which consists in the taking of risks, should any allowance be made from profits for extra risks taken?

Looking at business as a whole, the sources of extra profit during the war included:

- (1) extra wear and tear to capital assets;
- (2) remuneration for use of new capital at pre-war rates of interest normal for the business;
- (3) remuneration for *old* capital at extra rates ruling through scarcity of capital;
- (4) remuneration for *new* capital at extra war rates;
- (5) reward for greater responsibility and anxiety involved;
- (6) reward for longer hours of work;
- (7) reward for greater risk of total loss of assets;
- (8) reward for superiority in competitive skill;
- (9) extra luck (turn of prices, &c.).

The first was not regarded as profit at all, being an exhaustion of capital, and (2) was the only 'extra' for which a special allowance was provided. Each of the rest, except the last, was in some quarter or other the subject of argument for exemption, as not properly the subject of such a tax. But the scheme did in effect charge them. The underwriter's case was rather comparable with the third, the seventh, and eighth sections, and it is difficult to see

how their plea could have been admitted consistently with a refusal to allow to others a valuation of the extra risks run where they were called upon to launch out, or to face unknown factors. The scheme allowed for *double* the capital at stake at the old risk of loss (or rate of interest) but did *not* allow for the *same* capital at stake at double the old risk of loss. The latter was in the main the underwriters' position. They used the premium income to pay their claims (generally keeping it in fluid investment); the real point was that their primary security had been in greater danger. But, in the same way, so had the primary security of many traders.

Analogy led to an allowance on the new premium income at the *pre-war rate* of profit, from the whole profit (including remuneration for extra risk, subject to tax), which was the claim put forward at first. But the underwriters' subsequent proposal was more drastic against the Revenue, since it claimed at a new war rate against the whole difference of premium income:

Difference in premium income	£15,000
15% thereon is £2,250	
Excess profit 1914, over datum £5,000—£1,000 =	£4,000
Allowance for risks	2,250
<i>Taxable excess</i>	£1,750

An examination of a number of instances led to the view that in 1911 and 1912 profit did not exceed 10 per cent.

The large claim by the underwriters for an allowance of extra rate of risks exceeded anything given to any one else. Even the more restricted claim for pre-war rate of interest, or profit, on larger 'capital' at stake was not wholly valid. The ultimate personal capital *capable* of being lost was not really greater—it had run more risk of being lost and this greater risk had been paid for. The profits were not really of a different order from remuneration for greater expenditure of time, risk to health or life and limb, or to goodwill.

Although 'capital owned and employed' was not an immediate test, it could be referred to as an ultimate test. A *company* doing marine insurance would, to remain in business, have to pay a minimum rate upon its subscribed capital, after remuneration for management. When the rate was correctly

observed, the ratio of profit (including management charges) to premium income could be found, and that ratio would then be regarded as the standard ratio, for it could be linked up ultimately with the endurance of the standard rate of interest in that business. Such a ratio would then be a competitive rate to apply to private insurance underwriters as the ratio essential to their business in the long run, with a deduction for the actual return to the capital where it was employed. For example, if marine insurance companies with all the capital at stake actually in sight, had to return 8 per cent. to attract subscription (or to stay at par) and the normal investment of funds returned 4 per cent., the balance of 4 per cent. had to come from the underwriting profits as such, and if that return represented x per cent. on the premium income required to make such a profit, then x per cent. on premium income was a fair rate to allow when the capital involved for private underwriters was unknown or hidden. The words of the section were designed to admit such a calculation, but in general terms. In the ultimate result the Board of Referees made their order on these lines, with this difference, that instead of treating the factor of premium income as a fixed equivalent to capital and the statutory percentage as the variant, they left the statutory percentage alone and expressed the new factor as a fraction of statutory capital. Obviously 3 per cent. on the premium income gave the same result as the statutory percentage 6 per cent. on half the premium income, and they chose the latter form of expression as more in keeping with the statute.

(2) *Ships*

Even at the time when the first Act was passed, it began to be clear that the position of shipping would be abnormal. The provision that upon a change of ownership in a business a new start could be made by the purchaser, who might, if he wished, ignore the original profits standard and claim a percentage standard upon his new and inflated purchase price, opened a vista of possible and widespread evasion in the case of shipping. Under existing income-tax law it seemed that a ship itself could be regarded as a separate business, thus acquiring a new and

higher standard on each occasion of changing hands, whereas it was fairer to consider the 'business' of shipping as that belonging to a person or firm, with a succession of changing assets, entitled to change the standard only by reference to the actual changes in capital. The special provision of the Act, observing the principle of generality, made no specific mention of shipping, but applied to a business 'confined to the management of any particular assets with power to substitute other assets for those particular assets'. Its purpose was illustrated as follows: A person bought a ship two years before for £50,000 which might now be worth £100,000. As a vendor he might reinvest the money in another ship, and thus start with a capital of £100,000. An ingenious but simple process of 'exchanging' ships at high prices would ensue, with the complete elimination of liability to duty. The Act provided that upon the purchase of other assets only additional capital provided *from outside*, and not capital obtained through the sale of the first assets, would be recognized as an increase of capital. In the same way, for computing the allowance for obsolescence, on an ultimate fall in value only the original capital plus bona-fide new outside capital would be recognized as the 'value' from which the reduction would be reckoned. For example:

Original ship cost	.	.	£10,000
Sold for	.	.	£30,000
New ship bought	.	.	£31,000

The capital in the business for all purposes of the Act would be limited to £11,000.

Before this device was adopted, a Government amendment appeared upon the paper—ultimately disappearing without coming before the House at all—which provided for profit on the sale of ships being specifically charged to tax. The effect in the above case would have been a payment of duty by the vendor of £9,900 (i.e. £30,000 — £10,200 = £19,800 at 50 per cent.). It would then have been possible for the Revenue to allow the purchaser to start afresh with his actual capital outlay of £30,000. The reason for the withdrawal of the plan was discreetly undisclosed. Certain members of the Government were aghast at the sudden introduction of the hated principle of taxation of capital, which is

always so alarming to British ideas,¹ and more especially at such 'shameless discrimination' against one particular form of capital. I did some running backwards and forwards to accommodate the views of ministers who were in all other respects bosom friends, but hopelessly divided upon this issue. There were other kinds of sales of assets going on, not perhaps so striking in their effects, nor attracting so much public attention, and they argued that no plan could be equitable which did not treat them all alike, public clamour concerning shipping notwithstanding. The introduction of a general tax on capital sales was a project of too doubtful expediency at that time.

In this instance, therefore, after a brief period of inter-ministerial negotiation, the offending clause was withdrawn, and this provision for the mere prevention of evasion through 'ringing the changes' took its place. But the whole question became daily more acute. The prices being obtained for ships became almost fabulous, and unless the vendor reinvested in ships, or the purchaser was substituting one ship for another, the Revenue seemed likely to lose all the duty from this industry by a succession of new capital values, each carrying a higher percentage standard, and enormous obsolescence allowances that would come into operation at the end of the duty when prices were expected to fall. Yet it was fair that a bona-fide purchaser at a high price should have just the same rights and privileges in regard to the capital so invested as he would have had in any other industry. Meanwhile, the vendor would have escaped scot free with the 'capital profit'. The dilemma was real. It seemed absurd that in the case of two similar vessels with the same pre-war cost and the same war profits the State should lose enormous sums of duty in the one case compared with the other, merely because the one had changed hands. And yet the direct charge on profit was so abhorred that, despite the pressure of facts, the Government feared to face its introduction and the probability of internal dissension.

But the Chancellor got neatly past those who had said they

¹ Thus, in commenting upon the British Income Tax, Dr. Haig says: 'When one asks an Englishman why capital gains are not taxed, the first reply is almost invariably a surprised and shocked exclamation to the effect that this would mean the taxation of capital and not of income.'

would not object to tax of *general* application, provided there was no discrimination against a particular kind of asset, and a resolution was passed in Committee of Ways and Means authorizing the levy of a 60 per cent. duty on the excess of the price realized for the sale of a 'profit-producing asset' over the pre-war standard of value. Once again the storm burst, and before the Finance Bill, 1916, was published, the original intention of imposing a tax upon vendors was abandoned and the representatives of the shipowners had agreed to support an alternative method of attaining the object desired.

This scheme abandoned the idea of a tax on vendors; instead it placed a purchaser precisely in the position which the vendor would have occupied if he had not sold his ship: it thus denied to the purchaser the exceptional reliefs which till then would have created a loss of duty. The result as regards all *future* sales was that the intending purchaser, in bargaining with the vendor, would have to take into account his larger liability to duty, and would 'throw back' the duty, so far as he could conjecture its amount, on to the vendor, who, by obtaining only a reduced price, would indirectly bear the burden of the duty.

The method was an ingenious device for getting at the vendor indirectly—a kind of 'back-handed' scheme of taxation. It consisted in being deliberately and consciously 'unfair' to the purchaser of a ship, denying him all the reliefs and privileges that would ordinarily apply to his case by reference to the amount of his investment, and giving him only those allowances and standards that the vendor had enjoyed, based upon the pre-war circumstances. The Government's answer to the protesting purchaser was to be: 'Yes, we agree you are suffering special disabilities compared with other investors; you must estimate by how much you are likely to be unfairly treated, and *offer less for the ship*—knock it off the purchase price.'

When receiving the Shipping Deputation on the 20th April 1916, the Chancellor explained that his object in introducing this resolution was not necessarily to impose upon a vendor in the actual terms of the Finance Bill a tax of 60 per cent. of the *whole* of the excess of sale price over pre-war value (which might include a considerable sum paid in anticipation of excess profits to be

earned *after* the termination of the war), but rather to accompany the charge foreshadowed in the resolution by allowances so framed that the net amount actually chargeable would equal the amount of the two exceptional reliefs or allowances (for percentage on capital and for obsolescence) which, though denied to a vendor, were enjoyed by a purchaser, and which accordingly involved a leakage of revenue. He stated that he did not wish the Revenue either to lose duty or to gain duty as the result of a sale.

The problem, however, of finding a satisfactory formula by which the amount chargeable under a vendor's tax could be rendered equal to the amount of a purchaser's reliefs proved extremely difficult in practice, because the post-war value of ships and similar assets was then entirely conjectural, and the duration of the war also unknown. The shipping representatives who were asked to make suggestions were unable to produce any satisfactory scheme to give effect to the intentions of the Chancellor as explained to the deputation.

The principle of amortization is a well-known one in the theory of taxation, and it is recognized that it is extremely difficult to get a *differential* burden or privilege to stay where it is put in the first instance, and where it is desired it should rest. But this is a unique instance of a Government deliberately invoking the principle, and being differentially unfair, with the intention that economic forces in the market shall prevent the burden staying where it has been imposed. The theoretical answer had one clear weakness. The law was made to apply to sales which had taken place at any time *since* the outbreak of war, but *prior* to the passing of the Act. In the case of sales subsequent to the passing of the Act, the purchaser, when negotiating with the vendor, was able to take into account his larger liability to duty, and throw back the increase, so far as he could estimate its amount, on to the vendor. But where sales had taken place prior to the Act obviously he had no opportunity of shifting the burden. The Chamber of Shipping were alive to this, and virtually agreed to protect the Government from being abused on this account.

In their application the provisions were very complicated,

especially where shares of ships in 'sixty-fourths' changed hands, or where fleets were dealt with as a whole, or where ships were bought on borrowed money.

The following example (which disregards the £200 allowance) illustrates in detail the possible leakage of duty and the way in which it was met by Section 47.

<i>Vessel X.</i> No change in ownership.	£
Pre-war value	30,000
Pre-war profits	2,000
War year profits for, say, three years each	20,000
Total E.P.D.—one year at 50 per cent. and two years at 60 per cent. on £18,000 per annum	30,600

Vessel Y. Similar conditions except that the vessel is sold at the end of the first war year for £50,000.

E.P.D. receivable on original basis:

Vendor's first year: 50 per cent. on £18,000	9,000
Purchaser's duty: Two years gross profits £40,000.	

<i>Deduct:</i>	£
(a) Standard, say, 7 per cent. on £50,000	3,500
(b) Further wear and tear allowance (4 per cent. on £50,000 less £30,000)	800
	<u>4,300</u>
Two years	£8,600
(c) Obsolescence allowance. Assuming the vessel to be worth £30,000 at the end of the war.	
Price paid	50,000
Wear and tear allowed	<u>4,000</u>
	46,000
Post-war value	<u>30,000</u>
Capital depreciation	£16,000
Total deductions	£24,600
Excess chargeable	15,400
Total purchaser's duty at 60 per cent.	9,240
Total duty for three years	<u>18,240</u>

Under Section 47 this loss of duty, amounting to £12,360, was prevented. The purchaser's standard became £2,000, no allowance for further wear and tear or for obsolescence was due, and the purchaser's duty, like the vendor's, was calculated on £18,000 each year.

Shipping profits continued to be the 'storm centre' of public criticism of profiteering. The Government had been forced to push on with their schemes for general requisitioning of vessels and the limitation of shipowners' profits. Sir Arthur Salter has

described graphically and fully the situation early in 1917, in which year the shipping position became more serious than at any previous time. The cardinal facts were:

1. Time charter rates rose to 40s. a ton and even 50s., compared with 3s. before the war and 13s. to 18s. in 1916. Requisitioning was being extended to cover practically all British ships, at uniform Blue Book rates.

2. In February 1917 the intensive submarine campaign began. The losses in April were at such a rate that if they had remained unchecked the Allies would have lost the war in a few months. The situation was so grave that many thought it hopeless.

3. At the end of 1916 the Transport Department was a fully developed and efficient office taking increasingly large responsibility. The Government established a new Ministry of Shipping under the Shipping Controller, constitutionally based upon an Act of Parliament. The old departments concerned with shipping questions were, of course, at once absorbed and supplemented.

4. It was desired to extend requisitions over all British vessels, and not merely those required for Government services. Up to this point the 'tramps' had borne the brunt of this work. 'By the end of 1916, however, with the increase of the range of Government control, it became evident that liners could not continue to enjoy their immunity. . . . Early in 1917 the Government decided upon universal requisition, partly in order to secure closer control and partly to restrain profits. All lines were formally requisitioned and paid for at Blue Book rates. But the owners continued to run them and to fill any space not occupied by the increasing quantities of Government supplies by offering freight on the market in the ordinary way, the freight, however, being henceforth on Government and not private account.'

Up to this point the profits made by shipping had been the most notorious and striking of any section of industry, and the capital gains of those who sold ships outright were the subject of widespread wonder and disapproval. Even where ships were lost by submarine action, the enormous recovery from the underwriters made it almost a short cut to riches to get one's

vessels torpedoed. As Sir Arthur Salter clearly shows, individual owners were powerless to keep down freight, and were not wilful profiteers. Under free competition conditions it was impossible to prevent prices rising, and any individual philanthropist would have benefited his morals and not the public. 'Government action alone could make it either possible or useful to reduce freights below their full competitive level.'

Proposals to reduce profits, by control, to pre-war levels, led to discussion as to what period might fairly be taken. Over a long period to 1912, shipping had yielded very meagre profits, and the years 1913 and 1914 stood out as most remarkable boom years.

It is equally certain that the high profit of 1913 had not come to stay, for a severe depression was then in sight. Many people contended that to remunerate the industry on the basis of 1913 results was to give an unduly inflated standard and that justice would be done by a much lower basis.

The profits of shipping, which were about £8 or £9 millions from 1909 to 1912, rose immediately before the war to about £20 millions, and, of course, the aggregate pre-war standard (in which each taxpayer had a choice of periods for his standard) was somewhat higher—about £24 millions. Sir Arthur Salter says: 'Probably in the first twenty-six months of the war, the total net profit of British shipping amounted to at least £262 millions, with an appreciation in value to about £500 millions.'

A very large proportion of the total yield of excess profits duty up to this period had come from shipping, and the ship-owners had therefore enormous sums standing to their credit, available, if necessary, for repayment against any future deficiencies below the pre-war standards. It has already been indicated that such pre-war standards were unusually favourable to this industry, and it was therefore clear that any real restriction of profits to a modest level of interest on pre-war capital would automatically create 'deficiencies' for duty purposes. The Government were in this dilemma: Public opinion was pressing for a genuine and real restriction of profits to a pre-war or economic level. But as from the 1st of January 1917, the rate of excess profits duty had been raised to 80 per cent., and this

rate became, of course, applicable to all deficiencies. As fast, therefore, as the Ministry of Shipping reduced profits below, say, about 24 per cent. on capital, the Inland Revenue would make good the greater part of the reduction by repayments, and nothing that the Government could do would really reduce profits to a level that the public regarded as defensible.

In the budget of 1917 Mr. Bonar Law made the bold proposal to discriminate in taxation against shipping profits, and cancel their right to receive refunds of excess profits duty on account of deficiencies. This action raised a storm of protest from shipowners, who contended that their right to receive refunds was as much a governmental obligation or contract to them as to any one. Even moderate and unbiased opinion found it difficult to accept this position. The *Accountant* said:

‘The Government’s excuse for the exceptionally particularized method is that Shipping Companies have made very exceptional war profits in the past, and that no real hardship will result from the restriction. This appears to be a very roundabout argument. Surely if Shipping Companies have made larger excess profits than other industrial companies the correct remedy was to have limited those profits, when only proved offenders would have suffered, but now a Shipping Company which did not make more profit than other trades is to suffer for the Company which was allowed to retain the abnormal profits in question.’

The clause was vigorously, almost bitterly debated, and was finally altered so as to effect a compromise between the two extremes. As from the 1st January 1917, shipowners were still to be allowed repayment for deficiencies, but only to the extent to which actual profits fell below the percentage standard, which was generally a much lower standard than the profits standard. For example, if a shipping company had a steamer costing over £100,000 before the war, the profit standard might well be £20,000, but the percentage standard only £6,000. If the profits for 1914, 1915, and 1916 had been £20,000, £50,000 and £70,000 respectively, the duty paid would have been £48,000, available for refunds. If in 1917 the profit was reduced to £15,000 duty would be neither payable nor repayable, but if it was £2,000, the duty repayable was 80 per cent. not of the £18,000 deficiency below £20,000, but 80 per cent. of £4,000, the deficiency below £6,000.

(3) *Stocks of Commodities*

It occurred not infrequently that stocks of goods which were owned by a business and which that business would ordinarily sell piecemeal in the normal course of its trade, were sold *in bulk* in such circumstances that the transaction could not be treated as a trading transaction, but had technically to be treated as a *capital* one; the sum received could not, therefore, be treated as part of the trading receipts and any profit on the transaction escaped taxation. This kind of sale occurred on the winding-up or sale of a business or reconstruction. There was nothing to stop traders from winding up their businesses or even exchanging businesses to evade duty, for the vendor in such cases escaped duty on his lump sum profit, and the purchaser made no profit unless he could sell in the ordinary course of trade above the (high) price which he had paid, and made no excess profits unless any profit exceeded a fair return on the 'capital' involved.

Although the theoretical possibility had existed all along, it did not assume practical importance until the sale of whisky stocks in Scotland. The value of these stocks had been enormously enhanced since the outbreak of the war, and their aggregate value was estimated at £120 millions to £130 millions, as compared with a cost of perhaps a quarter of that amount. So far as these stocks were sold in the ordinary course of trade, excess profits duty was paid on the increased profit due to the enhancement of value, but so far as they were sold in bulk in transactions which had technically to be regarded as capital transactions, the excess profits duty, or nearly all of it, was lost, and the loss was, therefore, potentially many millions of pounds sterling. There were a number of such transactions certainly prompted by a desire to avoid duty. It was decided to discourage similar sales in future, or if such sales took place, to ensure that the profits contributed their proper quota to the revenue.

The majority of the sales which had taken place were sales of going concerns, and the exemption under the existing law was fairly definite.

Attention was drawn to the matter in various Parliamentary questions. It also attracted the attention of Lord Shaw's

Scottish Liquor Trade Commission, in connexion with investigations into the value of the Scottish liquor trade, and it was specially referred to in their report. Feeling on the subject in Scotland ran high. Although it was open to other classes of business to adopt the same practice there were no indications of such action being taken.

Many advocated that this charge should be made retrospective, for something was to be said in theory for taxing transactions designed to evade duty, but such cases could not be distinguished from those which were entirely bona fide and not due to the temptations of the duty.

Moreover, in a large number of cases—where the sales took place during the liquidation of a business—the proceeds of the sale had already been distributed among shareholders. But the issues involved in sales of stocks in bulk were unimportant compared with those raised by the general question of the ‘Valuation of Stocks’. As the scarcity of particular commodities raised their price, but more particularly as the general price level rose rapidly with war-time inflation, traders became increasingly apprehensive of their ultimate fate. They saw themselves paying 60 and 80 per cent. upon ‘paper profits’, as they called them, due to swollen values, and being left to bear alone the whole loss due to the subsequent deflation after the duty was repealed and all chance of recoupment for deficiencies had passed. In June 1917 the Association of Controlled Establishments put up a plea to value a fixed (pre-war) amount or quantity at pre-war prices, in arriving at these stocktaking values for each accounting period, and to have special treatment for any surplus quantities. From this date onwards the battle was fought with swaying fortunes, most vigorously on both sides—the officials and accountants *contra mundum* with ministers leaning towards the traders and deterred only by the fearful prognostications of loss of revenue constantly uttered by the officials.

Nevertheless, it was an eminent chartered accountant Member of Parliament, Sir John Harmood-Banner, who led the attack. His proposal was that *in the case of every business in every class of industry* a quantity of stock equivalent to the pre-war quantity (at the end of the standard period) might be carried at the pre-

war price, thus creating a hidden reserve which in many cases would be enormous.

As regards any surplus stock (over the pre-war quantity) held at the end of the last accounting period, a period was claimed for realization, and credit was to be given for realizations below the cost or the market value at which the stock had been valued.

If the final stock was less than the pre-war quantity the trader was to be allowed to charge (as if it were a working expense to be incurred) the difference between the cost at the time and the pre-war cost of the amount of stock which should be deficient.

Although this clause appeared to relate to the single subject of valuation of stocks, in the difficult issues it raised there were brought out at least three distinct but related questions:

1. What are the correct and generally accepted methods of valuing stock for the purposes of business accountancy and of determining business 'profits', and how far do rules which may be proper for normal times require modification because they are strained beyond reasonable bounds in times of abnormal inflation or abnormal fluctuation in price levels?

2. What was the test of the true *profit* of a year or period? Was there such a thing as the 'profit of a year', taken separately without looking to the time before and after?

3. Did the principles underlying the excess profits duty justify, and did the existing industrial conditions demand in the application of that duty, a recognition of the *equalization* of profits over a period of years?

In discussion with the various deputations and bodies making representations in the matter, these issues were generally inextricably mixed, and slight differences of view about fundamental points led to a wide divergence in practical proposals.

It is necessary to look at the elements of the part played by 'stock' in the determination of profits, if the full bearing of the proposals is to be realized. A profit is considered to arise when goods have been sold for a larger amount than they have cost, after deducting expenses; and therefore to reckon a profit upon goods which are unsold merely because the market price is such that if they were sold they would realize a profit is to 'count one's chickens before they are hatched'.

The ideal simple account would read:

Goods sold	£20,000
Less paid for the above goods	16,000
Profit	<u>£4,000</u>

But in practice some of the goods sold were bought in the previous period, and some goods have been bought during the year but are still unsold, and the account should stand in detail strictly as follows:

Goods sold	£20,000
Cost of goods purchased last year, but sold as above	£4,000
Money spent for goods purchased during year	£24,000
Less, for unsold goods	<u>12,000</u>
Cost of goods both bought and sold in year	<u>12,000</u>
Total cost of goods sold in the year	16,000
Profit	<u>£4,000</u>

When the goods are purchased one cannot say whether or not they will be sold during the same year, and therefore it is impossible to put them into two categories (i.e. 'this year's sales' and 'next year's sales') at the time. The only practicable method is to keep one account of purchases, and then at the end of the year to look at the unsold stock, *find the cost of it*, and deduct the result from the purchases. The difference gives the cost of the goods bought and *sold* in the year.

Stocktaking is therefore a device to eliminate half-completed business from the completed and profitable business, and the entry of the amount at the end of the year in the accounts as a contra entry to *purchases* of the year is an effort to find the *cost* of the goods sold and the true business of the year.

It is clear from this that the fundamental rule of true accounting for stock valuation must be 'cost' price. If any other figure is taken, something more is done than the mere elimination of future business indicated above. A value *higher* than 'cost' in the example above would have the following result:

Goods sold	£20,000
Cost of goods purchased last year, but sold as above	£4,000
Money spent on all purchases	£24,000
Value (not cost) of unsold goods	<u>16,000</u>
'cost' (False) of goods both bought and sold	8,000
Total 'cost' (false) of goods sold in the year	12,000
Profit	<u>£8,000</u>

In the same way a valuation at lower than the 'cost' will make the cost of the goods sold in the year appear *more* and decrease the profit.

It is true that the increased 'profit' in the first case is merely an anticipation of the next year's profit, but all the same it is not in *fact* a realized profit of the year and such accounting is very rare in commercial practice and is never permitted by reputable auditors.

But in the converse case, to anticipate any future *loss* if the market price of the day when stocks are taken is below the actual cost price, is considered to be a prudent and reasonable course and is widely followed. The anticipation of the loss is a 'secret reserve'. If the goods so valued in one year are ultimately sold at that reduced price in the next then the loss has already been taken account of in the first year and the profits of the second year are unaffected, but if the expected does not happen and the goods are sold at a profit, then the second year's accounts include a *double* profit, viz. the difference between the valuation at the beginning of the year and the actual cost (a book-keeping profit) and the difference between actual cost and actual sale price (a real profit). From this emerges the general rule:

'Valuation at cost or market value (if lower).'

The first position taken up by claimants was that conditions had become very abnormal, and that as prices would drop continuously at the end of the war (and of the excess profits duty) it was not sufficient to adopt the reserve against subsequent loss given by the ordinary rules of valuation, or even a further *proved* loss in the subsequent year when the goods bought in the war year were realized at a lower figure; but that the situation demanded an allowance for prospective losses on *future* purchases and sales which would arise on the assumption that the prices would be continually dropping.

If it were assumed that wholesale and retail prices would double in a war year and then go back to their former level in the subsequent peace year the ordinary rules would give a result in the following form:

Normal year.

Cost of <i>x</i> goods bought in previous year . . .	£10,000	} £16,000 sold for £24,000
„ <i>y</i> „ „ „ during „ . . .	6,000	
„ <i>x</i> but not sold at end . . .	£10,000	
		£8,000 profit.

War Year.

Cost of x goods bought in previous year as above	£10,000	} £20,000 sold for £34,000 £14,000 profit.
„ y „ „ during year	10,000	
„ x „ but not sold at end of year	£20,000	

Peace Year.

Cost of x goods bought during war year but not sold as above		} £20,000 sold for £18,000 £14,000 sold for £18,000
Cost of y goods bought this year and sold		
„ x „ „ but not sold at end	£10,000	£2,000 profit.

The ordinary judgement on the matter is that in the war year a profit of £14,000 was made, succeeded by a profit of £2,000. But the claim made was that the profit of each year was really quite different:

War Year.

Cost of $x+y$ goods sold and x goods unsold	£40,000	} Sales £34,000 £4,000 profit.
Less normal value of x goods at end unsold	10,000	
	£30,000	

Peace Year.

Value of x goods bought in previous year	£10,000	} Sales £36,000 £12,000 profit.
Cost of y goods bought in the year	14,000	
Total 'expense' of goods sold	£24,000	

That is, the secret reserve of £10,000 on the stock at the end of the war diminished the 'war period' profit from £14,000 to £4,000, and increased the peace-time profit from £2,000 to £12,000.

But if a man had gone out of business at the end of the war, buying in no goods for future sale, he would undoubtedly have made £14,000 in the war year.

No serious arguments were put forward to show that the general rule of valuation at cost was not normally sound. The attacks then made upon it were directed to its operation in exceptional times: an analysis of the argument used led to the contention that even granted that a *prima facie* 'profit' was shown, this could not be adopted as the true *profit of the year*, in so far as it was affected by circumstances which had not *spent* themselves within the year. Any future adverse effects which would attend those circumstances must, it was argued, be set against present effects, and it might not be possible to tell the true profits of the year for a long time, indeed till the old equilibrium was reached. The true profit could, it was said, be reached only by anticipating future adversity, i.e. by averaging the

‘accountancy’ profits. The business career must be looked at as a whole.

Upon examining this new position, it was found that no amount of ingenuity could alter the plain fact that the ‘profit’ as commonly understood was actually large in the one year and small in the succeeding, and that the statement that an average profit was made in each year was an abuse of facts and of language. In substance it boiled down to ‘Granted that the proper way to arrive at profits is that shown, and that such a result is the true profit of the year in question, nevertheless, in times of abnormal and fluctuating profits it is only common prudence to *equalize* results.’

This could be admitted on grounds of prudence so far as the *spending* or withdrawal of profit by proprietors is concerned, but it did not alter the facts as to the *making* of profits. Then it was said that this prudence should be respected and adopted by the State for taxation purposes and that all ‘excess profit’ through increase in prices was, in the long run, illusory because it was lost, and the duty should therefore not apply to such profit. This was obviously a matter affecting the fundamental principle of the duty. We had been made familiar also with the argument for an ‘output allowance’, viz. that the tax should apply not to profit derived from increased work and a larger volume of production, but only to profit through *increased price*. Now the converse plea was put forward that profit through increased price was largely temporary and should not be subject to tax either! Where then was the excess profits duty?

There was even a third line of attack put forward on the principle that in so far as excess profits were required by the recipient to meet increased costs of living, &c., they should not be subjected to tax.

The main assumptions underlying the case as put forward and on which alone it could be justified were of very doubtful validity:

- (a) Even though prices might fall after the war, there was nothing to indicate that they would fall to pre-war levels within any period that could have reasonable connexion with excess profits duty. The tendency to look upon pre-

war conditions as the true normal to which all things must be restored was shown in its most violent form. It was not realized that the question whether the price level of pre-war times could ever become the normal price level again was quite as much a matter of currency as of supply and demand of commodities.

- (b) *Losses* were not necessarily and inevitably made in periods of gradually falling prices. By concerted action, tacit and instinctive, or open and arranged, the fall in prices of finished and retailed goods might lag behind the fall in the price of raw materials and wholesale goods, so that a *normal* profit and not a loss might be made throughout.
- (c) The stocks carried at high prices might be far smaller in quantity than those accumulated at low prices.

It was impossible to escape the conclusion that the proposal did not represent a method of ascertaining the true profits of the years in question, but was a device for the equalization of profits over a long period of years, which must defeat the aims and objects of any tax framed upon the lines of the excess profits duty.

The ideas which had invested the pre-war level of prices with an ultimate immutability had given a similar peculiar sanctity to the *quantity* of stock held by each business just before the war. The notion of the ideal price was therefore applied strictly only to the ideal stock, and separate proposals were made for cases where the quantity of stock was more or less than the pre-war quantity. It was claimed that any sale of stock during the war which had reduced the quantity held by the business below the so-called 'normal' quantity, and which had not been counter-balanced by new purchases, should not be regarded as a 'trading' sale at all, but as a kind of capital sale, or an encroachment upon the assets of the business.

The proposal was, therefore, that the profits of such a sale should be eliminated from taxable profits, by allowing a 'notional' expense to be charged, viz. the future expense of restocking to an equivalent extent. This proposal ignored the fact that a full profit might subsequently be made upon that future purchase when it came to be sold, and it also confused the goods

which it is a man's whole object in business to sell with a totally different class of assets such as machinery and plant and buildings. It required a great deal of special pleading to justify the contention that a profit on what a man is 'out to sell' was not a real profit at all, because he had sold rather more of it than he usually did.

There were a limited number of cases where the contention had some weight, viz. where raw material is continuously associated with plant which must be maintained at a full level to secure the economy of a continuous manufacturing process, and these were provided for.

The clause proposed was thus designed to achieve three ends:

- (1) To allow a so-called 'normal stock' for *all* classes of business to be carried or valued at a constant or base price throughout the duration of the excess profits duty (any surplus above the normal stock being valued on the ordinary principles, viz. cost or market value, whichever was the lower);
- (2) to treat any sales encroaching upon the 'normal stock' as if they were capital transactions, so that the profit should not be chargeable; and
- (3) to provide for a period after the war during which special allowance should be made for any actual loss on the realization of stocks above the 'normal stock' in hand at the end of the last accounting period.

In the result, the 'normal stock' at a base price was admitted to be a legal method of valuation for excess profits duty in certain limited conditions, viz. in the case of manufacturing industries, holding stocks of imperishable raw or semi-manufactured materials, where the practice of such valuation already in fact obtained generally in the industry. Where a material body of practice did not so exist, and in all non-manufacturing industries, the principle was not admitted. But the principle of treating sales of stock (in reduction of the normal stock) as if they were non-trading sales not giving rise to taxable profits was definitely repudiated. In 1918, on the contrary, the Government proposed to tax *all* sales of trading stock in future. Then a

period of two years for 'realization' after the war was promised which should apply to the whole stock of a business and not merely to surplus above the 'normal' stock.

The 'Valuation of Stocks' controversy was revived in 1918 to the extent to which the agitation was not met in July 1917 by the following proposed amendment: 'At the end of each and every accounting period the stock of a manufacturer in any trade or business then on hand shall be brought into the accounts for such period as to any quantity not exceeding that brought into account at the commencement of the first accounting period ending after the fourth day of August, nineteen hundred and fourteen (hereinafter referred to as "normal stock") at the same prices as those at which the latter was so brought into account.'

Nothing had occurred since the debates of July 1917 to indicate that the cost of the proposal to the Exchequer would be any less than was then indicated, and it was still clear that it might run into hundreds of millions of pounds in duty.

Since that date, however, in business circles, there had been a hardening of opinion in the direction that the 'two years' concession at the end of the war would be of doubtful value. The chief reasons urged were as follows:

- (1) The fall in prices would, generally, not occur until some time after the war, probably several years.
- (2) That the allowance of a loss on only *one* 'turnover' of the stock was quite inadequate, as losses would continue to be made on succeeding purchases of stock until a stable price level was reached.
- (3) That the concession agreed upon would be difficult to work in practice, as it would often be hard to determine exactly the 'loss on realization' on particular stocks, especially if they consisted of semi-manufactured goods. Moreover, the idea of 'loss' was said to be indeterminate—it might be restricted to mean (i) the difference between cost or valuation and actual gross selling price, (ii) the difference in (i) increased by selling expenses, (iii) the difference in (i) increased by selling expenses, interest on capital, and a proportion of all kinds of overhead expenses,

or even, as some had claimed, (iv) the difference as in (iii) plus the loss of profit that might have been made in ordinary times.

- (4) A distrust of Government promises, alleged to be general on the ground that where the Revenue had once got the money it would repudiate such undertakings, or whittle them down.

Combined with widely vocal dissatisfaction with the 'two-year' concession in certain quarters, there was the gradual discovery of the fact that the number of industries able to claim the application of the base stock method, on the ground of an existing practice, was exceedingly small, and that the industries affected were not by any means the most important.

In the interval, the Association of Controlled Firms and the Federation of British Industries issued detailed circulars to their members to formulate the evidence necessary for claiming the application of the base stock method, but from all the evidence available it was clear that although the base stock method existed sporadically in individual cases throughout all classes of industry, it was quite exceptional for the majority of members in any trade to practise it.

As a consequence of these facts, efforts were made to obtain a review of the position set out in the White Paper. The agitators had failed to move the Chancellor, and turned with more success to the Minister of Reconstruction, who found himself practically pledged to an inquiry before becoming alive to the fact that he was roaming over a province that belonged peculiarly to the Exchequer. Official protests led to this incursion into the Chancellor's field being decently camouflaged in the following terms of reference: 'To inquire and to report as to any measures which could be adopted with a view to securing that manufacturers should be financially in a position to hold stocks after the war, and that reasonable safeguards are established to prevent financial losses as a result of possible depression following on a period of great inflation in respect of stocks of materials required for industry.'

The *raison d'être* of this inquiry was stated to be that traders were apprehensive for financial reasons and could not take the

risk of holding stocks and that there would in consequence be a dangerous depletion.

I had the responsibility of being the Chancellor's official representative.

It was suggested by the Inland Revenue Department at the time that no live issue would really come before the Committee under its terms of reference except that of the valuation of stocks for excess profits duty, and this prophecy was borne out by events, for nearly the whole of the evidence was devoted to a criticism of the White Paper and the Inland Revenue administration thereunder, and to discussion as to the principles of accountancy and of war taxation.¹

The Close of the Duty

The conditions under which the duty was brought to an end enabled some of the early ministerial undertakings to be given effect to in a rather surprisingly symmetrical manner. Liability terminated at varying dates between 4th August 1920 and 5th August 1921, in such a manner that every business was subjected to a total charge over exactly seven years (except for businesses begun after 4th August 1914, where the fixed date 31st December 1920 was taken). The closing rate of duty was 60 per cent. as at the opening, and, since all other rates operated as between fixed dates, the effect was that the total number of months subject to the 60 per cent. rate was the same in all cases, for those that had a greater number at the beginning had, *pro tanto*, fewer at the end. Owing to the different rates of duty and the uneven rate at which excess profits were made, it was possible for the net effect of charge and set off to be a payment of duty more than the net excess profit over the whole period, and the surplus was remitted.

Relief in respect of the closing stocks of goods was the chief item to be dealt with in closing the duty. First came the 'leveling process' made necessary by the rapid change in prices in the period during which different businesses closed their liability at different dates. The trader was allowed to compute his closing stock values as if they were valued at 31st August 1921, and if

¹ See Appendix II for a statement of the Committee's findings.

this was less than his actual closing valuation, he was permitted to deduct the difference from his last year's profit, or in other words to substitute the special valuation. But the deduction was not allowed to exceed a certain limit, tested by the actual deficiency of the closing result, below the percentage standard. There were also some allowances for forward purchase contracts not included in the valuation. Next came the undertakings of the White Paper Scheme (Cd. 8623 of 1917) under which the actual realization of stock during the next two years, plus the revised value of stock unsold, could be taken as the closing value.

Alternative to this, at the trader's option (to be declared not later than 31st March 1922) was a relief based on the recommendations of the *Financial Risks Committee*. If the profits of four years after 31st August 1921, due to the fall in prices, were less than the percentage standard, repayment of 80 per cent. of the deficiency was given, but this was limited to a sum equal to 40 per cent. of the average excess profits (not duty) of the last two years brought under charge, and of course also to the aggregate duty paid for the business. No information has ever been given as to the numbers who availed themselves of the respective options.

The number of actual assessments made for the excess profits duty (including the munitions levy) was 406,000. The total excess profits dealt with was about £3,500 millions, the actual duty assessed was £2,047 millions. But £64 millions was 'set off' against deficiencies direct, £453 millions was discharged through reductions of assessments, &c., and £256 millions was repaid for deficiencies or allowed for interest on prepayment. These deductions amounted to £773 millions. Thus the net liabilities came to about £1,274 millions, and the net receipt to the end of 1929/1930 was just under £1,200 millions, leaving about £75 millions still under inquiry and settlement, ten years after the repeal of the duty.

The Administrative Factor

Much has been said throughout this work concerning the psychology of the taxpayer, and the amenability of the legislature in securing the success of war taxation. But all competent

observers are agreed that the administrative factor was also of immense importance, and that without great tradition, resource, elasticity, and ability no such success would have been possible. The difficulties of a new, *ad hoc* administration compared with a tried, and even sorely tried, established machine were well illustrated in the early history of the munitions levy. The excess profits duty was put upon a staff already over pressed, and being constantly denuded for military purposes. But the extent to which the expert local administration was trusted with discretion to work out details, under a highly autocratic and informal central direction, made success possible. Professor Haig of Columbia had many opportunities for assessing the importance of the question and the calibre of the staff. He said: 'This recognition of the importance of the administrative work impressed the writer deeply in the course of his survey. It appeared to be one of the most striking points of contrast with the American situation. The Chancellor of the Exchequer, for example, evidenced great pride in the skill and ability of the Inland Revenue. The same spirit was indirectly shown when others expressed the most complete scorn for those countries which permitted lax administration of their revenue laws.' And in another connexion: 'If general praise from every one, including the taxpayers themselves, is any criterion of success in the administration, the assessment and collection of the British duty has been very well done. The writer, after contact with officials of the Inland Revenue, with accountants whose practice brought them into close touch with the administration, and with taxpayers, is filled with admiration for the efficient manner in which the machinery has operated and the general satisfaction it has given. Every one agreed that the service had been promptly and fairly performed, that in spite of the complexities of the law, there had been almost no bungling, that outright evasion, at least during the war, had been practically non-existent, and that the integrity as well as the intelligence of the administrative force had been beyond praise.'

In his comparisons with the American methods he referred to the onus put upon the taxpayer, and his view was 'that the practical result of the spirit and the organization of their ad-

ministration was to put the initiative of claiming the benefits of such special procedure squarely upon the shoulders of the taxpayer alone, who would benefit from its adoption.'

'There could scarcely be a greater contrast than that afforded by the attitude of the British administration and that of the ordinary local Collector of Internal Revenue in the United States, and much of the dissatisfaction with direct taxation which unquestionably exists in this country is traceable to the strict, petty, stickling over minor, inconsequential details. Long experience has taught the British the importance of vesting discretion in capable hands and insisting that that discretion be used fairly but in a generous spirit.'

This discretion has a great effect upon the taxpayer.

'As a result of this different distribution of assessment functions in which the surveyor is given a high degree of authority and responsibility a situation arises in which it is neither necessary nor desirable that the taxpayer be required to become fully informed as to Treasury interpretation and departmental procedure. Consequently the Board of Inland Revenue issues no flood of interpretative material which it asks the taxpayer to digest and accept as a rule of action. He has the statute and almost nothing more.'

The second factor lay in the development of the theory and principle of the legislation itself.

'We have not grasped the fundamental importance of adequate preliminary consideration of tax measures. The British seem to be able to choose a course and hold to it consistently. It was only about one year after the war began that they established their excess profits duty, but even at that early date it was established in a form which they have found unnecessary to change in any important particular. To-day they have essentially the same scope of application, the same definition of profits, the same standard of excessiveness, the same rules for calculating invested capital, and the same general procedure as they had at the beginning. We began with a law of broad application and then swung to the opposite extreme of very narrow application. We began with an invested capital standard, the next year we substituted an alternative standard, and the

third year reverted to the first type once more. We have tinkered with the definition of profits and made important changes in procedure. The British contented themselves with mere changes in rates to meet varying fiscal needs. Our constant changes have had many unfortunate effects, perhaps the most serious being the tendency to unstabilize business and to complicate the administration. It does not reflect credit upon us that we, in 1917, could not draft an act suited to our situation, whereas Great Britain was able in 1915 to pass a law which has required practically no revision since.'

The United States had an income tax administration that was young and unsettled, and exceedingly fickle in its lifelong allegiance to the Civil Service. The Germans had all the difficulties of a federation with a high degree of local sentiment. By their own showing the Americans did not appraise the administrative factor at its proper value.

'We are on the whole not slow to grasp the significance of underlying principles, or to appreciate the theoretical niceties and refinements of these complicated tax measures, but we appear to be willing to ignore the existence of many of the administrative problems upon whose solution the success of these measures depends,' and Dr. Haig's comment on the British system of discretionary agreement shows how widely apart two administrative methods for a similar problem can be.

'The surveyor is encouraged and supported in a policy of arriving at "agreements" with taxpayers. These agreements virtually carry the force of a bargain entered into by two responsible parties and in the absence of fraud or deceit they are not disturbed. The taxpayer gets certainty and quick decisions. The Government keeps up to date with its work and gets its money promptly—probably more money than otherwise. British officials express amazement at our cumbersome methods of administering a tax of the type of the excess profits tax. In cases of difficulty this surveyor supplied the taxpayer with skilled advice and assistance in the preparation of returns and ordinarily was able to arrive at an "agreement" without requiring an appreciable amount of effort and time on the part of the taxpayer. The fact that the taxpayer can trust the surveyor to pro-

tect his interest as well as that of the Government is a feature which impresses the American observer.'

It may be wondered whether war-time legislation and the changing complexities of business could possibly be harmonized, for no Act of Parliament can deal with unforeseen and abnormal cases.

'The British appear to have achieved success where we have failed, for it is clear that they have been able to solve the problem of the abnormal case with a fair degree of satisfaction to all concerned.

'The British have shown us that it is possible to introduce sufficient flexibility into the administration of a profits tax to enable it to conform fairly satisfactorily to the complex conditions of modern business. They have also shown us how to eliminate the friction which arises when important questions of judgement are left entirely to bureaucratic officials.'

It may well be thought that with a high degree of discretion, corruption or discrimination would ensue, for the officers were given wide powers.

'The Board of Inland Revenue has specifically said to the local surveyors that "owing to the present high rates of taxation" they desired that in doubtful cases the allowances granted in calculating excess profits duty should err on the side of generosity rather than otherwise.'

But Dr. Haig's searching investigation revealed no trace of this. 'The writer found no one in England who intimated that there had been any discrimination in the administration of the duty. All agreed that even-handed justice had been given as between business and business so far as it was administratively possible to achieve it.'

A concluding comment, on a matter which is rather delicate for an Englishman, himself a participant, to enlarge upon, may be quoted from Dr. Haig.

'The formulation of the official interpretation of the duty and the preparation of the instructions to the surveyors were entrusted to a small informal committee of high officials in the Inland Revenue which was formed shortly after the passage of the Act. Later the special problems which arose in the course of

the administration were placed before this committee for consideration. It was a body too informal to have a definite name or title. It consisted of four men, three being Secretaries to the Board and one a member of the staff of inspectors. It performed approximately the same duties as the groups of economists and business men known as the Excess Profits Tax Advisors and Reviewers performed for our Treasury. It should be especially noted that this body was entirely separate from the Board of Referees specifically established in the Act to care for certain appeals and cases of unusual hardship, with which our "advisors" and "reviewers" are very often compared.'

The British tax administration is essentially a secret preserve from all other Governmental functions. It does not allow its material to be used for any other purpose than taxation, and even statistics are jealously prevented from being 'revealing'. Unlike other countries, the right hand of Government certainly does not know what the left hand is doing. But under war conditions, sometimes the left hand was kept informed of the right hand's actions.

For example, particulars relating to contracts made during the war by the War Office, Admiralty, and Minister of Munitions were forwarded to inspectors and were used by them as a basis for specific inquiries as to liability to tax. Used with discrimination, such material had great possibilities as a check on the accuracy of accounts, especially since the taxpayer never knew the precise extent of the knowledge of the inspector.

Reciprocal action was often desired, but never conceded, the oath of secrecy taken by tax officials being a complete barrier.

CHAPTER VIII

CONCLUDING OBSERVATIONS

A CRITICAL survey of the whole episode of war finance puts it beyond challenge that the tax system of Great Britain stood the shock and the expansions better than any other. The broad policy of providing in additional permanent taxation enough to meet the post-war debt charges was pursued with success, and a substantial additional sum towards war costs from special taxes was also raised. The fact that post-war errors of judgement served to discount the effort made is beside the mark. It is true that taxes ought to have been—wisdom after the event—raised at the outset of war, and the excess profits tax introduced earlier; the munitions levy ought never to have been introduced at all. But these are small matters beside the main achievement, and from the administrative point of view the results were remarkable. Foreign observers, almost without exception, give the highest praise to the British system and record. Mr. Fisk, the American writer, said that Englishmen delight in heckling and finding fault, but the quiet student many miles away could only marvel at the results achieved. ‘They could only be obtained in a country where patriotism runs so high that the people demand to be taxed and taxed heavily’. French and German opinion is equally emphatic.

It is idle to state that inasmuch as all war must be paid for out of current production (except for sales of securities and foreign loans) it can be raised by a blend of taxes and loans, and inflation is unnecessary. That is a counsel of perfection. The illusion of prosperity, and the incentive to production created by inflation have their real value in war-time, provided that they are not carried out of hand, and silent taxation of this kind is probably inevitable in any long and grim struggle. It is not an arithmetical problem, but a psychological one, whether the debt was ‘unnecessary’. Mr. Snowden and Mr. Hartley Withers have taken the more stringent view, while economists like Professors Pigou and Seligman have put more stress upon not hampering production. The inflation caused by loans gives the personal

illusion of high wages, although, since money wages nearly always lag behind rising prices, as real wages they are not nearly so high as the wage-earner thinks, and the incentive to him is greater than the social cost. The same inflation gives a great 'boost' to money profits, for ever advancing costs lag behind receipts and the real profits rapidly expand. Speaking from long observation of the effect of this upon manufacturers and business men, I should say that the pride of profit-making, even though the bulk of the profit is taken away soon after by almost penal taxation, is greater in its net effect upon total effort and production than the limitation of prices and profits, with the absence of such taxation. It may be illogical, but it is human nature. It was often urged that 'they ought not to be allowed to make such profits, and then no taxes would have been necessary.' I think that the evidence of a necessary incentive for output was overwhelming during the war. The existence of the illusion of war profits not only increased production, and made a greater contribution to taxation possible, but it also, as soon as resentment against luxurious expenditure set in, increased the incentive to lend heavily. The other side of the argument is that the inflation that brought all this about also increased the costs of war and created a vicious circle. This is true in a large measure, but the argument that, in a wiser and more patriotic world, illusions and incentives would be unnecessary—that the whole costs of war could be met by taxation, or certainly by taxation and loans, with no movement of the general price-level—must be answered by the statement that in fact men are yet neither wise nor, in a final sense, patriotic enough for this course.

It would seem ungracious, after the many tributes paid to the readiness with which the British bore their taxation programme, to question their ultimate ounce of patriotism. But the ideal patriot would, in war-time, produce and work as hard as he could without financial incentive; he would be more than meticulously careful not to waste or be prodigal of the country's resources; he would be more scrupulously honest than ever. But in fact large numbers of people were weak in one or other of these respects. High taxation during the war led to a great increase in account 'cooking' and fraud. The Inland Revenue

made little public fuss about it, but for ten years since the war they have been busy bringing it to book, and a large specialized staff for this 'penalty' work has been brought into existence, the members of which are somewhat cynical on the question of war patriotism. Then the high tax rates undoubtedly produced prodigality and waste. When a clerk wanted a rise of £100 it was easy to be generous, since it affected the payer to the extent of £10 or £15 only, the bulk of the cost falling upon the State in the reduced liability to tax. Generally, if a boon costing £100 were worth having at £20, the incentive to spend freely was very marked. Again and again, the margin of incentive to work harder and take greater risks was in doubt in particular cases. Towards the end of the war the cry 'take all excess profits—tax 100 per cent.' gained currency, amongst even reputable thinkers. Mr. Bonar Law had serious Cabinet trouble on the question of raising the duty from 80 to 100 per cent., and it fell to my lot to make the most vehement and earnest written protest and warning to him, which he circulated as a Cabinet paper. Such a course, in removing all incentive to production, and giving every incentive to waste, would have had a devastating effect. The constantly repeated analogy with conscription was responsible for the idea. But while men could be compelled to go into the firing line, and compelled to advance, instead of retreat, by force, and by force of example, it is impossible to make a business man work harder or think more sensibly or clearly—in short, to be a better business man—by standing beside him with a revolver.

The incidence of this taxation was often in question. Men asserted constantly that when taxes were put up prices were put up to cover them, and the Government were made to pay their own taxes. Professor Haig, the American critic, said upon this problem:

'It is not easy to understand how a tax which is imposed only after moderate profits have been accumulated can operate in an important and direct fashion as a cause of high prices, if the market is freely competitive. Even in a seller's market such as exists in many lines to-day, the power to charge a high price is not dependent upon the existence of such a tax. There probably are long-time indirect effects in the direction of increased prices from a business tax such as this. If the duty does encourage laxity in management, there would be a reflection in prices. The slightest repression on enterprise—and this tax undoubtedly does

exercise some repression in the long run—would be expected to have such effects. . . . In general it is clear that the effect of the duty in Great Britain has been repressive, but it is not evident that it has been more restrictive or repressive than any available alternative would have been. The writer found only one business man, among the dozens questioned on the point, who professed to believe that the duty was more repressive than a capital levy, the substitute most actively advanced. . . . Thus if the profits tax is actually borne by the business and not shifted in increased prices the business man may offer his wares to a community whose purchasing power is unimpaired. If the sum now raised by the profits tax were placed directly on articles of consumption in the form of commodity taxes it is conceivable that this method of raising the money might prove to be repressive, perhaps even more so than the profits tax, because of diminished purchasing power and disturbed conditions resulting therefrom.'

He enunciates the general economic doctrine when he declares 'Such tender-hearted tyros at profiteering who depend on the tax to give them moral courage to charge what they can get for their goods in the market are probably rare economic phenomena and, moreover, unless they happen to be selling directly to the consumer anything they refrain from adding to their price is probably added to it by the next man in the marketing chain, so that the ultimate retail price is no lower.' All the same, in many instances there was not a freely competitive market, and the urgency of the Government as buyer was the greater of the two, and its knowledge of the facts the less, while the seller was personally interested in an objective sense, and the official was doing an impersonal sum on paper, so that the pull was often with the seller; and it is difficult to dissent from Dr. Haig's view that

'there is general agreement in England that in the case of commodities manufactured under Government contract, especially during the earlier years of the war, the Excess Profits Duty was very often taken into account in arriving at a price. That is, the manufacturer usually considered the Excess Profits Duty an expense and succeeded in securing terms which left him after paying it about the amount of profit he would have striven for had the tax not been in existence. Consequently the tax in England was probably to a considerable extent illusory, the Government itself creating the profits which it took back in taxes.'

I commented upon this at some length in 1921 (*Economic Journal*) and urged that after 1917 the possibilities of direct addition to price became less, but that the indirect effects of repression and waste became greater, and that true marginal

costs were increased. The two arguments on effects are distinct, and, to some extent, opposed. 'It does not lie with those who must use the repression argument to urge so vehemently that any tax that is paid is passed on to the consumer in higher prices than would otherwise have existed.' The whole question of the incidence of high direct taxation was dealt with at length by the Colwyn Committee on Taxation and the National Debt.

The final, and accidental, effects of war taxation were extraordinary. If the excess profits duty had been taken off—as was confidently expected—as at the end of 1919, before the great slump of 1920 set in, the Revenue would have retained very handsome surpluses that in fact had to be given up. For at the last moment before the budget of 1920, largely, it is said, at the instance of Mr. Lloyd George, Mr. Austin Chamberlain decided to continue the duty for another year and to raise it to 60 per cent. Shortly after, the price-level broke, and by December 1920 enormous business losses had been made. These losses nearly all fell to be borne by the Revenue to the extent of 60 per cent. out of the excess profits duty paid or liable on the earlier years, and repayments in respect of this year 1920 have been on an enormous scale. In 1921 I wrote: 'The extension of the duty virtually to August 1921 with the great liabilities it is throwing upon the Exchequer, seems likely to turn that scheme of taxation in many instances into the most complicated arrangement ever devised for borrowing money for five years without paying interest on it!' (*Economic Journal*).

At the same time, two qualifications have to be made. Even if the duty had ended before the slump came, the rather elaborate provisions which had in any case to be made for the valuation of trading stocks at a still later date would have resulted in much larger allowances and repayments under that head than were actually required, for the margin of difference between the value at the terminating date and the later valuation date would have been very much greater. In the second place, the large recourse to Exchequer repayments must have saved many hundreds of firms from serious difficulties and even bankruptcy, so that the 'cushion' of Revenue reimbursement had valuable industrial effects.

The constitutional aspects of taxation were often in jeopardy.

Customs merged into prohibitions, excises into penal and avowedly social forces. The direct taxes were envied as engines of industrial direction. Not only were these overworked services dependent on a thousand or so trained minds, continually struggling against the demands of the military arm, which saw in them only eligible field fighters, and not finance fighters, but the department was also frequently defending the citadel of taxation and its integrity against a host of new and well-meaning attacks. As soon as any industrial activity came under control of Government—generally in the person of the newly imported business man—profits or prices were controlled and the tempting device of taxing profits and pooling them was thought of with a proposal to ‘contract out’ of the general or Imperial liabilities. Again and again this menace was fought, and the generality of taxation under one fiscal authority re-established. Dr. Haig said: ‘During the early years of the war there developed in England a considerable diversity of special profit-appropriating devices. For a time each of a number of bureaus and departments had its own particular brand of “private” profits tax which it felt was best adapted to its needs and which it desired to apply in place of the excess profits duty.’ The most serious contest was with the munitions levy on controlled establishments, which has figured much in the preceding pages, and this owed its bitterness to its importance, the prestige and support of Mr. Lloyd George, and the political significance of the levy with trade unionism. Ultimately it was absorbed administratively by the Inland Revenue. The next in importance was the ‘Coal Mines Excess Payments’, which also fell to the Inland Revenue to administer, after a difficult struggle by the writer to prevent a natural process of interference with general taxation. The mines came under control from 1st March 1917, with all kinds of restrictions. Instead of general compensation to aggrieved parties, a scheme was devised which added 15 per cent. to the 80 per cent. excess profits tax, leaving only 5 per cent. to the colliery owner. This 15 per cent. gave the Controller a fund out of which to compensate owners whose profits fell *below* their profits standard. The officials were not allowed to use the common terms ‘duty’ or ‘tax’—they were entitled to say ‘liability’ and ‘recovery’.

The effects of war taxation were to stretch to a remarkable extent the whole idea of taxable capacity, and to set hardly any limit to the ideas of democracy about the available wealth to be used as largess by this means. But the essential difference in this process upon a falling price level has not even after twelve years dawned upon the average mind. It left us with the McKenna duties as an apparently permanent instalment of special protection and a first breach in the principles of Free Trade. It left a single permanent new tax in the entertainments duty; by suspension, it practically removed the new land taxes. It made the income tax into a new and highly differentiated system, and it completely changed the proportions between direct and indirect taxation, which had been 57·5 per cent. direct and 42·5 indirect, and became 72 per cent. and 28 per cent. respectively. The burden per head was raised from £3 11s. 4d. per head to £22 per head.

When the war had been over long enough for some stability of production to be resumed, the net social income was found to be hardly changed, the real income per head had slightly fallen, but the real home-produced income per head was about the same, despite increased unemployment and reduced hours.¹ On the whole, wealth became more widely distributed² and the distribution of net income, after taxes were paid for social services, was definitely changed. The weight of taxation on different classes may best be judged from the Colwyn Report, from which we may quote that the total burden on an income of £150 per year (wholly earned) rose from 4·4 per cent. pre-war to 9·0 per cent. at the end, and 13·5 a little later.

On £200 a year from 4·0 to 7·9 and 11·8 per cent.

„ £500	„	„	4·4	„	10·2	„	8·0	„
„ £1,000	„	„	5·2	„	16·9	„	14·1	„
„ £5,000	„	„	6·7	„	36·6	„	28·5	„
„ £20,000	„	„	8·3	„	47·6	„	42·3	„
„ £50,000	„	„	8·4	„	50·6	„	48·0	„

The rates on investment income were considerably higher.

¹ *The National Income, 1924*: Bowley and Stamp.

² *Ibid.*, and Stamp, *Wealth and Taxable Capacity*, Colwyn Report.

A comparison of the British effort with that of other countries is too wide for this volume, and, indeed, it cannot properly be made without taking into account also the 'aftermath' and the course of events in the succeeding ten years. The story of the vicissitudes of French public finance is eloquent upon this aspect. But it can safely be said that in no country is the record of war experiment and experience in taxation more full of interest for the political psychologist, the economist, and the historian than in Great Britain, and these annals, if they have not done justice to it, are at any rate the words of one who was there to see.

APPENDIX I

EXTRACTS FROM THE REPORT OF THE MINISTRY OF RECONSTRUCTION'S COMMITTEE ON FINANCIAL RISKS ATTACHING TO THE HOLDING OF TRADING STOCKS

... The great central fact brought to our consideration is the enormous rise in the prices of raw material and goods. To quote a few instances from the evidence:

	1914.	1918.
	£ s.d.	£ s.d.
Swedish Pig Iron has risen from	5 10 0	to 45 0 0
Swedish Bar Iron „ „	12 0 0	„ 70 0 0
Copper, Electrolytic (c.i.f.), has risen from	60 0 0	„ 120 0 0
Lead has risen from	22 10 0	„ 41 0 0
Zinc „ „	25 0 0	„ 60 0 0
Tinplates, per box (c.i.f.), has risen from	13 0	„ 2 0 0
Nails have risen from	7 10 0	„ 38 0 0
Galvanized Wire has risen from	8 0 0	„ 37 0 0
Wire Netting „ „	9 5 0	„ 30 0 0
Cement, per Cask, has risen from	7 6	„ 1 6 0
Cotton, per lb. „ „	4½d.-7d.	„ 27d.-30d.
Paper, News, per lb., has risen from	1½d.	„ 7½d.
„ „ Better Quality, per lb., has risen from	2½d.	„ 1s. 2d.

Timber:

Pitch Pine, per load, has risen from 70s. to 280s.

Ash, per cub. ft., has risen from 2s. 7d. to 6s.

Mahogany, per sq. ft., has risen from 5d. to 2s. 6d.

We do not accept responsibility for the typical character of all these quotations, but they represent, on the whole not unfairly, the movement of prices.

No such rise as this has been known in our generation. To find a parallel we must go back to the struggles of Europe in the Napoleonic era—a time from which lessons may be learnt, although the conditions of labour and employment were widely different, and markets had not become cosmopolitan. Times of high prices are usually followed by times of depression; and it is urged that such depression is the more certain and acute when the main cause is the ravage and waste of war. Without entering upon debateable ground, five main causes can be adduced as likely to operate in the reduction of general prices. Insurance of war risk necessarily disappears, whilst the carrying capacity of the world, on the restoration of normal conditions, will probably be ultimately in excess of trade requirements. This means a lowering of freights. Thirdly, labour on demobilisation will be more plentiful than during the war, with the result that there will be a fall in wages compared with the rates prevailing during the war. Fourthly, after the war, the demand for military material ceases, and the country's capacity for production is

switched on to the supply of staple commodities, now standing at scarcity prices. Fifthly, if the wise recommendations of the recent Committee on Currency and the Foreign Exchanges obtain acceptance, there will be a 'steady and continuous reduction' of the increased issue of Government Notes until an effective gold standard is attained. To these causes may be added a sixth. Confidence has a potent effect upon trade, and want of confidence reacts upon the trader. Bankers are fearful of lending. Enterprise is timid of borrowing.

For these and other reasons, the trader of this country, expecting a fall in general prices, is reducing his stocks to a minimum. His view, moreover, is that wherever high profits are now being made, owing to the rapid rise in prices, they should not be spent or dispersed in any way, but held over to meet what he regards as inevitable future loss.

It has been argued, to reassure the trader, that falling prices do not necessarily injure him. He goes on buying and selling. If he sells cheaper he buys cheaper, whilst the rate of profit may remain satisfactory. Undoubtedly there is a measure of truth in this argument. Much may be achieved by prudent operations. The loss during a period of falling prices is certainly not so great as has been put to us by many witnesses. And the level of prices in the future is hardly likely to be as low as that prevailing before the war. Yet we consider, on the whole, it has been established that this apprehension is well founded, and a considerable drop in present inflated prices is likely to affect prejudicially many of our staple industries. In some cases profits may merely return to their pre-war level, but in many others there is likely to be actual loss.

A natural corollary to this apprehension is that the trader should wish to take a very conservative valuation of his unsold stocks. As he fears future loss, he desires to carry over the bulk of his excess profits, and he urges that the Government share of those extra profits (80 per cent. plus the income tax on the balance of 20 per cent.) is so great that the amount to be carried over is wholly insufficient to meet the anticipated losses which will fall entirely upon him.

The bulk, therefore, of the evidence before us has centred around questions of taxation, which, though not actually mentioned in our terms of reference, are inevitably involved in them.

The trader puts forward three lines of possible relief:

- (1) Lower rates of taxation during the war.
- (2) The Government to bear a share (out of the taxes now received) in any losses after the war.
- (3) A re-definition of 'profits' now chargeable to taxation, by way of the allowance of special reserves as expenses in arriving at profits, or more particularly by the adoption of principles of valuing stocks, when making up periodical accounts, other than those generally obtaining in industry hitherto, or admitted by the taxing authorities.

It is here necessary to turn aside and make a brief examination of the principles underlying valuation.

The custom of business is to ascertain the result of its trading from time to time by a survey of its operations. Commercial practice has fastened upon a year as the most convenient period over which this survey should extend; and the practice of accountancy has been to regard profits (or losses) as arising from the *sales* during this period. (In an economic world otherwise constituted, traders might have preferred to hold that the profit or loss of the year is the result of everything *bought or done* in that year, in which case the profit of the year might not be determinable till some years after.)

The ideal method of making up the Trading Account of the year might be to charge it only with the cost of the goods actually sold in the year (corresponding to the sale prices credited in that year) and to carry to a separate account all expenses relating to goods not sold during that year, as in suspense on account of the next year's trading. In practice this course is inconvenient, for no one can say at the time of purchase when the goods unsold will be sold.

The same effect, however (viz. that of confining the trading profit to the sales of the year), is obtained by a contra-entry representing the goods *unsold* at the end of the year. As the entry for Stock which appears in a Trading Account is merely intended to cancel the charge for the goods purchased which have not been sold, it should necessarily represent the *cost* of the goods. If it is more or less than the *cost*, then the effect is to state the profit on the goods which actually have been sold, at an incorrect figure. From the gross profits resulting from this account fall to be deducted charges on account of the diminished value of the capital assets of the business through wear and tear, &c., actual or anticipated losses on debts and other expenses, which entail some periodical revaluation to get the net profit. The general overhead working expenses are of course usually charged as applicable to a particular period of time and fairly represent the charge which should be made against the sales of the year. From this rigid doctrine one exception is very generally recognized on prudential grounds, and is now fully sanctioned by custom, viz. the adoption of market value at the date of making up accounts, if that value is less than the cost. It is of course an anticipation of the loss that may be made on those goods in the following year, and may even have the effect, if prices rise again, of *attributing* to the following year's results a greater amount of profit than the difference between the actual sale price and the actual cost price of the goods in question.

The ground has now been cleared for an examination of the 'base stock valuation' theory, which has engaged much of our attention and nearly all that of our witnesses. We will endeavour to state it with fairness stripped of occasional inaccuracies of thought and extravagance of claim.

Business is a matter of continuity extending over a considerable period of time. Long and prudent views are necessary. Apart from the disturbance of war, the raw material in certain trades, and more rarely the finished or partly finished goods in other trades, are subject to great variations in value. When war supervenes this uncertainty of values permeates further into industry.

The advocates of the base stock theory of valuation hold that profits made on selling Article *A* cannot be ascertained, with strict accuracy, until Article *B*, which was bought to replace *A*, has been sold. Similarly the profits made on selling *B* are not ascertainable until Article *C* has been sold. In other words, the division of profits into short periods of time gives illusory results.

In a manufacturing business of a given magnitude there will always be a certain quantity of raw material, goods in process and finished goods. Similarly, in a merchant's business, there will be a certain quantity of stock-in-trade. For convenience sake we will call these quantities 'the immanent stock'.

The idea of the base stock valuation system is to take this immanent stock at a low figure. At the commencement of business the figure must be the actual cost. But so soon as normal profits accrue, a portion thereof is devoted to writing down the immanent stock, and this process is repeated until a conservative, and sometimes a nominal, figure is reached. Bankers pursue a somewhat similar policy. They write down their buildings to perhaps break-up value; they take a conservative view of doubtful debts, and they write down their holdings of securities to beyond the dictates of ordinary caution.

The object of both trader and banker is to stabilize profits, though there may be a mixture of other motives. A bank cannot afford to show declining profits; secret reserves are necessary against undisclosable losses. A business does not like to exhibit its profit (or loss) to rivals. Both are afraid of undue greediness in shareholders or partners asking for larger distribution.

Everyone will admit that good times should lay by for bad times. Any criticism, therefore, of these methods is mainly directed against the *form* they assume. Accountants, with a few exceptions, consider that these practices misrepresent the facts. In good times large profits are made. If it is desirable to make reserves against the future, part of the profits realized should be set aside as reserves and so denominated. If goods have been bought for £50, and their market price has not fallen below £50 at the time of striking a balance, it is a misuse of language and a travesty of fact to write their value down to £20 out of profits made by selling something else. The correct procedure, it is maintained, is to place the difference of £30 to reserve. The other side, retorts, 'No, I always require a certain quantity of these goods; they are like my plant and buildings; and I write them down to a value which I consider will

hold over a term of years.' The accountants reply: 'Surely you get into a quagmire of inaccuracy. Buildings and plant and machinery have recognized allowances for depreciation; your "immanent stock" will vary with the magnitude of your business. Why make a prudential reserve by assigning a value to it which is known to be at variance with market value? This stock is not plant, but is destined for sale and is being sold continuously.' And referring particularly to the contention that the profit on Article *A* is not ascertainable until Article *B*, which replaced it, has been sold they add that they cannot accept any relationship between the successive sets of transactions. They also observe that looseness of language leads to looseness of thought. A capable manufacturer keeps his records so that at every stage he knows what his raw material and goods in process have cost him. The assignment of values to the stock which bear no relation to its cost tends to obscure his survey.

The complaint is often made by the base stock valuation school that an insistence on the system of valuation at cost or market value is really to force business to write up values. The boot is on the other leg. No writing up takes place when material is valued throughout at what it costs or at market, whichever is less. On the contrary, the claim to value stocks at a base figure is a claim to write them down at the expense of profits.

Before reviewing generally the evidence or suggested measures of relief, the Committee propose to advert to the concession made by Government in what is usually called the 'White Paper'. . . .

. . . As the vast bulk of the industries of the country will not have the benefit of this concession, it remains to examine the one which we have first mentioned.

. . . Whatever be the decision on this question, the claim that the relief given by the Government should be continuous and cover more than losses occasioned by the sales of the stock held at the end of the last accounting period is really the crucial question for determination, and runs like a connecting thread throughout the evidence adduced before us. We propose to summarize the arguments advanced in support of this claim:

During this war there has been a phenomenal rise in prices. As the cost of production lags somewhat behind a rise in prices, capital during a period of advancing prices makes unusual and great profits. This has been indisputably the case during the war. The great industries of the country have been most prosperous. Owing to the exigencies of the State immensely the greater part of their profits has been diverted to the National Exchequer. After the war there will eventually be a very heavy fall in prices. Possibly the fall will not bring trade prices to the previous level, but it will be unquestionably very great. As the cost of production does not fall as fast as prices, capital will suffer unusual and great losses. These losses

capital will be unable to sustain, for the State has absorbed the reserves which capital would otherwise have accumulated during the antecedent period of prosperity.

Capital further adds that the action of the State has been altogether capricious. Industries which, as a whole, have been in the habit of keeping large undisclosed reserves by means of base stock valuations have been allowed to retain them, whereas everyone, in these exceptional times, would have adopted the same practice. The limitation of relief to a few has given rise to a sense of injustice.

There is, we think, no complete answer to this last contention. The State has allowed the base stock valuation in certain industries only, because it was in effect bound by existing case law to make the admission. It could not have done otherwise without recourse to special legislation. In all industries, whether receiving this concession or not, it has left untouched and untaxed the reserves accumulated prior to the war period. On the main issue, the real reply is that the State must take its revenues where it can find it, and that in subsequent times of depression it has no hidden cache from which to repay losses. The State is the tax-paying community. If the more prosperous of that community fall on evil times, and if assistance can only be rendered by additional demands on the less prosperous, the position is irremediable.

Is, then, the problem set us insoluble? We do not think we can usefully address ourselves to more than part of it. There are certain to be some cases where the drop in prices will be very great. If it is not in such cases practicable to avoid grave losses by a resort to 'futures' and forward contracts, we think that it is undesirable to foster the presumption that businesses have a claim in all circumstances to be kept alive by State aid. Should the business be of such importance to the country as to justify its sustention in face of all loss, the question would have to be considered on its merits as a thing apart from discriminatory taxation. Ordinary remedies devised for normal cases would be unsuitable.

We are likely to be attacked in another quarter for not suggesting any relief to those who pay no excess profits duty. Much may be argued in favour of a similar right to assistance. Our reply is that, in our view, the State is not acting here as a charity organization society. Rather, borrowing a simile from the cattle and poultry yards, it is endeavouring to keep in good condition its milch cattle and the geese that lay golden eggs.

We might also be expected to provide relief for cases where a business has denuded itself of its immanent stock, at the instance of the Government, to meet immediate needs. Such cases hardly fall within the terms of our reference, but we think they have an equitable claim for consideration, which is best preferred to, and granted by, the department of State to which the assistance was rendered, and which can judge the merits of the claim.

Suggested Remedies

The more hopeful line of approach to a partial solution of our problem lies in a consideration of the present rate of duty. An 80 per cent. duty encourages extravagance, for a manufacturer or merchant thinks lightly of increased expenditure when only one-fifth of the increase falls on him. Enterprise is discouraged, the reward being paltry. Little margin is left for renewals, development and capture of new markets, to say nothing of reserves against bad times. When we put any suggestion for relief to a witness, and coupled with it an alternative of a simple reduction of the duty to 60 per cent. or 65 per cent., we cannot recall a single case where he did not plump for the reduction. Indeed, if the rate had been left at that figure, little would have been heard of the base valuation argument, and this Committee would never have been called into existence. We are of opinion that, if the rate had not been raised beyond, say, 65 per cent. it would have been wholly reasonable to expect and require that taxpayers should furnish from the balance such reserves as are adequate to meet the difficulties which this Committee is called upon to consider. And we think that there is much force in the contention of witnesses that the revenue accruing from such a rate would have been little, if at all, lower than that obtained from an 80 per cent. rate.

It is difficult, now that the war is in effect terminated, and the situation of the taxing authority is under review, to formulate any proposals, particularly when we are necessarily in entire ignorance of the intentions of the Government. We prefer as a remedy, provided it could be made compatible with the current requirements of the Exchequer, that the rate of duty, for the accounting period approximating to the year 1918, and now in the course of assessment, be reduced to 65 per cent., on the understanding that the duty so given up is retained in the business, and not distributed. We regard it as most desirable that the position of business should be specially strengthened, when entering on the threshold of a period in which markets have to be reorganized or created, and in which industrial conditions are in a high degree uncertain. This provision would be without prejudice to the concession of a still lower rate for any future periods, if the state of the Exchequer permits. It is necessary to add this qualification, because, while the reduction to 65 per cent. for a period that lies in the future entails no such loss of revenue as must follow a reduction in respect of a period which lies in the past, and has been already under the anticipation of the higher rate, any material reduction *below* 65 per cent. in future periods, though beneficial to industry, would, in our opinion, undoubtedly diminish the aggregate yield to the Exchequer.

Such a reduction for 1918 might well be accompanied by a withdrawal of the first undertaking provided in the White Paper, for the latter was, after all, largely consequential upon the raising of the duty to 80 per cent.

If, however, in the present state of the National Exchequer, the course we suggest is impracticable, and the actual cash must be available to the Government, we recommend that a portion of the duty now to be paid be regarded not as a final payment of tax, but as a suspensory reserve, held on joint account by the Government and the taxpayer. The portion so reserved should be represented for the time being by a special kind of War Loan,¹ which would be so held for five years. Thereafter this reserve would revert entirely to the State; or, in circumstances to be set out below, would become wholly or in part (with accrued interest) the property of the taxpayer.

The advantages of this scheme are threefold:

1. It affords tangible evidence to the taxpayer of a definite provision made by the State towards prospective post-war losses.
2. It fixes a maximum limit to the Exchequer's ultimate liability on account of such losses.
3. Capital experiences great difficulty in the financing of its business during this period of inflated prices. Relief is at present afforded by excess profits earned but not paid in to the Government until eight or ten months after the close of the year under assessment, and by excess profits earned but not paid in during the running year. The existence of this reserve affords valuable collateral security, for it reassures the banker at the moment when anxiety is acutest, i.e. when profits are declining to a critical figure.

We suggest that the amount of this reserve should be 20 per cent. of the *average* excess of profits above the standard in the last two years under the charge to excess profits duty. (The Chairman and certain members of the Committee are of opinion that this percentage should be considerably greater.) When the last payments of duty are being made, the scrip of the special war loan to which we have referred would be given for the sum so computed, and ordinary tax receipts for the balance.

The circumstances in which, as we suggest, the reserve should not revert finally to the Government, but wholly or in part to the taxpayer, are as follows:

The taxpayer must show, at the end of five years after the war, that his average annual profits over that period are less than the amount of the *percentage* standard to which he was entitled, or would have been entitled, under the excess profits duty, and that these deficiencies have been connected with holding stock at falling prices (as distinct, for example, from bad management or reduced turnover), during that period. He would then be entitled to relief to the extent of 80 per cent. on those deficiencies, and the war loan, with accrued interest, would revert to him for the amount of that relief, but for no greater sum than the amount of the reserve. For example: A company has an excess

¹ It will be necessary to consult the Treasury on the feasibility of the scheme.

APPENDIX I

profit of £40,000 in the last two years of the duty, or an average of £20,000. In its final payments to the Exchequer, 20 per cent., viz. £4,000, would rank as Reserve (under war loan).

Its profits standard, for excess profits duty, was £15,000 (i.e. its profits in 1912 and 1913), or, say, 15 per cent. on its capital of £100,000. If, after the war, its average profit is £12,000, it has *no claim*, even though losses have been made at various times by sales on a falling market. But, if the profit falls below the percentage standard (6 per cent. on £100,000 = £6,000), and amounted, say, to an average of £5,200, it would get relief as follows:

Five years' Profits	£26,000
Five years' Percentage Standard	30,000
Deficiencies	<u>£4,000</u>
80 per cent. thereon	3,200

£3,200 of the £4,000 in suspense reverts to the taxpayer. If, however, the profits amounted, say, to an average of £4,000, only, it would get relief as follows:

Five years' Profits	£20,000
Five years' Percentage Standard	30,000
Deficiencies	£10,000
80 per cent. thereon	8,000
Relief confined to the sum in reserve	4,000

It may be well to explain here why the relief proposed should not extend beyond 80 per cent. of the deficiency. It will be obvious that if the deficiency ranked for relief in full, a trader, who found he was likely to be a claimant, would have no incentive to trade properly and keep his deficiency as small as possible, for the State would bear it all. We, therefore, consider that some incentive must be given him, which will, in effect, protect the State from such an abuse.

We do not pretend that the remedy we propose with the limit suggested meets all the possible or prospective losses on a falling market. But it is obvious that any relief must be limited and severely conditioned by the financial position of the Exchequer in the difficult years following the war, and by the burden that would be thrown upon other classes of taxpayers called upon to make good the charge to the Exchequer resulting from the relief. Hence, we cut out altogether from consideration all trading concerns which, though adversely affected by the fall in prices, still make relatively good profits, and deal only with those which are genuinely hard hit over an extended period, relieving them to an extent which pays more regard to the paramount needs of the Exchequer than to the degree of misfortune of the taxpayer. Any attempt to make the relations between the taxpayer and the State in the matter of relief on a falling market exactly parallel to and consistent with their relations

in taxation during the war on a rising market, is not practicable; and, if it were practicable, does not commend itself to us as in itself an aim to be pursued.

We have had under consideration variants of the above suggestion:

(a) in the method of arriving at the reserve.

(b) in the grounds and conditions of relief.

Under (a) Granting the necessity for reserving a specific *amount*, other methods have been put forward for arriving at it in practice.

One method would compute the reserve as a proportion of the concluding stock coming under the duty, on the ground that a remedy for difficulties arising through stock values should be closely associated with such values. The chief objection we find to this system is, that the amount of stock with which businesses are likely to be left at the end of the duty will be very variously affected by the war conditions, and some businesses will be holding practically none. A second method would compute the reserve as some proportion of the 'inflated values' (i.e. the difference between pre-war prices and war prices) upon a 'normal' stock for each business. Such a method involves very intricate and often impracticable computations on the accounts of every business, and throws a burden of work upon taxpayers and officials which would, in the final event, in a majority of cases prove to be work thrown away; for it would be devoted to the computation of a reserve which is not effectively required. For these reasons, the suspensory reserve should, in our opinion, have a readily calculable basis, such as the basis of actual excess profits suggested above.

(b) In view of the fact that the point to be provided for is the loss on stocks on falling prices, it would be natural to direct the relief towards proved and specific losses from this cause. It may not be difficult for a merchant whose materials are unchanged in character from purchase to sale, to pick out specific items where his stock cost a certain sum, and was subsequently sold at a loss; but for a manufacturer using raw materials passing through various stages of manipulation the problem is much more difficult.

We have preferred to provide for the extremes of bad trade, where the losses are due inferentially and by clear indication, but without detailed and specific proof, to the cause in question; this course appears to be fully justified by the terms of reference which cover 'serious financial losses' only.

We have had under consideration the point that some businesses, which have elected to adopt the reserve method, would find it undesirable to keep the matter open for five years, and would wish to close the whole transaction during that period. We suggest that they should be entitled, on giving notice within two months of the end of the third year, to take the average trading results up to that date, on the lines indicated above, and to have a claim upon three-fifths of the reserve only, bringing

the matter to a final issue at that point. The same right would exist at the end of the fourth year, up to four-fifths of the reserve.

It is not possible for our suggested remedy to have application simultaneously with that promised by the Government under Paragraph 1 of the White Paper; and we should accordingly have recommended, but for one consideration, that the latter be cancelled. The Government undertaking relates to the losses upon *one set of sales*, viz. of the stock in hand at the end of the excess profits duty, without regard to the general prosperity of the business in the long run. It may well be that businesses having a claim under the White Paper, on the faith of which they are now resting, will never even expect to be so depressed as to come within our proposal. We therefore suggest that undertakings given in the White Paper (made clear, as we recommend in paragraph 11) should stand; but that each business should state, when making its return for assessment for the last period, whether it proposes to come under the White Paper, or, waiving all rights thereunder, to come under the five-year war loan system of relief. This election is free from the objection which would attach to an option after the event.

APPENDIX II

EXCESS PROFITS DUTY. BOARD OF REFEREES

*Extract from the argument in the leading case of the Paint, Colour and Varnish Manufacturers application*¹

(*Mr. Clark*). It is the first case that has been before the Referees which raises the main issue of the question as to the profits in any trade where the average profit is alleged to be more than the average profits in the trades throughout the country. Apart from the statements of the witnesses that these abnormal or larger profits are due to the brains and exertion and personality of the persons carrying on the trade, I think no statements have been made that show that there are what I may call specific incidents attaching to the capital necessarily employed in this trade.

Under this Act the actual profits are in the normal case the pre-war standard. That is shown by section 40, sub-section (2). The original idea of the Act is therefore a comparison between the profits that a man made in the pre-war period with the profits he makes in the period during the war. It is true that, in certain cases, if you turn to No. 5 of Part II of the Schedule, you do get a comparison between a man's own profits and some other standard, but that is not a comparison of his profits with the profits made by others in that business; it is a specific comparison of his profits with the profits made by his predecessor. The reason for that is that you do, in a particular instance, put the man in the position of his predecessor, and say, 'Now you can take the actual profits of your predecessor'; in fact, the exception proves the rule that the true basis of comparison is a comparison of the profits in the business during what the Act calls the accounting period with the profits in the same business at a prior time.

Now this, I suggest, is the first and the most important conception of the percentage standard—that it is the pre-war minimum given, instead of the actual profits, for the purpose of allowing the unsuccessful trader to compare his profits in the accounting period with some other standard than a standard which admittedly would produce a hardship, that is the standard of an unsuccessful trader. I suggest that this is a standard which was set up solely in order to avoid hardship, in other words, to prevent a man being required to hand over the whole of the profits he made during a successful time. Instead of saying to him, 'You shall hand over to the State the difference between the profits you have made, or', as Mr. Stamp reminds me, 'hand over 50 per cent. of those profits, you shall

¹ This settles the point that the percentage standard was not necessarily based upon the pre-war average profits of an industry.

hand over and be taxed on the difference between the profits you have made and some reasonable standard'.

I would like to draw attention to the fact that throughout this Act all the adjustments from the actual profits which are the primary standard, that is, the profits as ascertained for income tax purposes—all the adjustments which are to be made from those profits are adjustments by reference to capital. If you look at section 41, you see that you have to make an adjustment for added or decreased capital; that is under subsections (1), (2), and (3). You have also to make an allowance for unremunerative capital by sub-section (4); and even the alternative factor which the Referees have power to deal with under section 42 (1) (and that is the very section under which this application is made), in certain cases, where the capital employed in a trade is small compared with the capital necessarily at stake, even the consideration there is capital. It is because the capital is small; it is not because the brains or the energy are small, but because the capital employed in the particular business is small, that the Referees may take some other factor if they find that the capital necessarily at stake is large compared with the capital employed; in other words you still have a standard of capital although it is a different sort of capital, that is the capital at stake, rather than the capital employed. I am trying to make the point throughout that it is the capital in this matter with which we have to deal.

(*Mr. Stamp*). Mr. Chairman, this case raises quite clearly—I will not say simply—as a single issue the question of average profits in relation to the percentage standard, and it is rather important, it seems to us, that we should have a clear conception of what the term really connotes, what the term 'average profits' includes, and what it excludes, in order that when Mr. Clark follows me he may show the application of the Act to those elements, if we should find that there is more than a single element in the general conception of average profits.

My remarks, to begin with, at any rate, will be economic considerations relating to the meaning of 'average profits', and if, at first sight, they seem to be a little academic and unpractical, in a minute or two they will, I think, be seen to be extremely practical in their application and very pertinent to this particular inquiry. I may say, as is probably known to most members of the Board, that the earlier economists sought for laws governing normal or average profits in the sense in which we use those words, that is to say, profits which come to the proprietor of a business from anything he puts into it—his money, time, and whatever else he may give. They sought to find out what were the laws underlying those profits, and why there were any profits at all, to begin with; secondly, why they were what they were; and thirdly, why one man made more than another, and why one business made more than another. They failed utterly in that inquiry, as every student of economic theory knows, because they looked upon average profits as a single concept,

and tried to find a simple law about a thing which was not susceptible of any single law. It was only when they started to analyse it and find its component parts that they began to get near the truth, and then they elaborated their theory and found a number of separate elements in 'average profits', which they set out in detail. The most remarkable thing is that as industry has developed every one of those single elements has been exposed to view to the eye of every man, so that he can now see that what was, in early days, considered to be a theoretical distinction is actually borne out by the existing differences which we find between businesses. It was impossible for them to find a general law, because the conception of average profits covered a conglomeration of things, and it is very important that we should see what that conglomeration consists of, in order to ascertain to which of the elements the Act applies, and to which it does not, in relation to the percentage standard.

The first thing they discovered as a separate factor (and by 'separate factor' I mean a thing which receives separate reward, and if it does not receive the reward, will normally tend to withdraw itself from that business to some other business where it will get such a reward) was that of economic rent. Taking all other things to be equal, they found two firms employed in business; they seemed to be equal in every other respect, but one made more profits than the other, and they found that it was the difference in site, or the fertility of the soil, which made the difference in the profits. This was economic rent—a surplus, not really averageable, and not strictly a 'reward' at all. That was the first reason they found for a difference.

The second they looked at was the difference in the capital employed, the saved-up wealth which was put into the business. They found a number of differences in the remuneration for that capital. First of all they found a simple remuneration for the use of money where it was absolutely secure in its return—where its yield was constant, year by year, where the investment was negotiable and the amount of capital could be got out again by sale. That is the minimum or gilt-edged return on capital, which is one of the most fundamental conceptions—one of the most difficult in economics. For instance, as the Board will remember, the rate has gone from something like 2 or $2\frac{1}{2}$ per cent. in 20 years to about 4 per cent., and we know that deep-seated causes related to the production of the precious metals and so on are at the bottom of a matter that is extremely difficult to set out in a few words. Then the second element of reward for capital is due to the risk of the total loss of capital lent, and thirdly, there is the difficulty in getting it out or negotiating it, if the investor wants to reinvest his capital. Then, again, there are the fluctuations of the yield in interest. Shall I call these (*a*), (*b*), (*c*), and (*d*); (*a*) being the rent applicable to the special position the man was in, and (*b*) minimum interest, (*c*) risk and negotiability, and (*d*) fluctuation—all the rewards for capital. I will not deal with the reward for a wasting

asset, because that is rather different in character. Then there were businesses with special fluctuations and risks, which we will call (*e*), in which the capital required still more interest.

They found that part of what was the general conception of profits in many cases was (*f*), the remuneration for direction of policy and general business knowledge. They found differences in profits owing to the amount of responsibility, and the technical knowledge required, and as we know to-day even in differences in dignity, for I suppose the Chairman of a Board of Directors may command a difference in remuneration, on such a difference as that between a C.B. and a K.C.B.—an instance in point.

Then the next thing I will call (*g*). It was that there were differences among men in their managing powers, due to knowledge, training, experience, or ability; we know that a man who has a capacity for managing a large business, and for being intimate with all its details, must have, in the nature of things, a larger remuneration. We know too that a man who has original powers, who is not merely able to conduct a business which has already been schemed on ordinary financial lines, but is able to re-scheme and re-arrange all the factors of production, like the invention of a new machine, commands the very highest rewards in commerce.

Then, lastly (*h*), they found that there were very often proprietors working in their own businesses and saving the wages of a man who might very well have been employed. For instance, I know a master grocer making £2,000 a year who sells behind the counter; he might save by that thirty shillings a week, and he gets that wage, which he 'saves', included in his profits. That was an element they found in some profits, and differences were due to strength, skill, &c.

The developments in industry threw up (*a*), (*b*), (*c*), (*d*), (*e*), (*f*), and (*g*) distinctly into view, and we find some of them included in profits and others in expenses, according to the character of the business. Take a large scale public company—it often has debentures, that is (*b*), as an expense, and (*f*) and (*g*), the remuneration for policy and direction, and the remuneration for management, are also both expenses. The *profits* of a large limited company are made up of any balance of (*b*), with (*c*) and (*d*) on capital, and perhaps also (*e*), the 'special fluctuation' reward. (In some industries they have developed a special business for taking over ordinary risks and dealing with them separately, but that is a separate category.)

We find, if we come to a small public company, that it may have (*e*) and (*g*) only, the special fluctuations (which it is not large enough to bear the risk of, and must insure for), and the remuneration for management, as expenses, and (*b*), (*c*), (*d*), and sometimes (*f*), as profits. Then a private company has only (*e*) and possibly (*g*), which is remuneration for management and superintendence, as expenses, while it includes in its profits

(a), (b), (c), (d), and (f). If (g) is a part of profits, then that is an extremely arbitrary and accidental division. For a small private company, it is merely a toss-up whether they will take the managing directors' remuneration at 33 per cent. or 10 or 50 per cent. and the balance as dividend, and we find in dealing with the excess profits duty the most extraordinary differences in similar businesses. It makes all the difference what a man calls 'remuneration' and what he calls 'profit'. Next a firm treats (a), (b), (c), (d), (f), and (g) as profits. A small firm or personal establishment will have none of them as expenses, and will include as profits, not only all the letters I have mentioned, but (h) also, the proprietor working as an employee in his business.

The sole reason I have for elaborating this is just to make this point, that when we speak of 'average profits' in relation to businesses managed in these different forms, we average a jumble of elements, some of which are in some cases included in expenses, and in other cases in profits—nearly all of which are in profits in some cases, and nearly all of which are in expenses in others. Strangely enough to a business man, when all these factors are remunerated (some of the things would receive for different persons a different reward—a kind of 'rent' for that factor receiving more than the similar factor elsewhere), economic science teaches, and teaches with some confidence, that there is no such thing as permanent long-run normal economic 'profit' in addition to those things; if you have something in addition to those remunerations, it is merely temporary, and every tendency of competition is that it shall pass away. It is like the waves, it is always tending to the level. I am speaking entirely in the sense that it is remuneration for all those faculties. The presence of monopoly, such as a tariff or some statutory restriction, or even internally created rings, may give more or less permanence if you can keep out competition. There may be frictional difficulties; it may be difficult for business men to acquire the necessary aptitude and skill to come into competition. It would be difficult for me to say suddenly, 'I will go into the paint trade'; but in the course of time men or their sons can be drawn to a trade that is particularly profitable. But each time profit appears (that is, special profit of that sort over and above remuneration), if it is capable of being bought at all, when it is sold it is capitalized and disappears. The man who sells it goes off with the capital value of the whole of the future advantage, and leaves the purchaser merely in possession of what is equivalent to the normal thing. That is human nature. These factors then get their proper economic remuneration, and nothing is left. If we take, for instance, *A*, £10,000 profit on £10,000 capital, he has 100 per cent., and we will regard him as a clever man. Everything else being equal, *B* has £5,000 and only makes 50 per cent.—he is a more ordinary man. *C* has £1,000 on the same £10,000 capital, everything else being equal but his ability, and he makes 10 per cent. All those in excess of *C*, who is merely jogging along, get something which

we submit is not interest on capital, although we often term it such; it is economic rent of ability in that particular case. We can follow the factor in every case, and get the return in relation to the factor. We will test it by a business, and its net return on the capital: you take in a new manager with more than the average technical skill, and the profits go up. He says, 'My remuneration was £1,000 and I want £2,000 now'; you say 'Why?' and he says 'The profits have gone up'. You say 'My percentage has gone up from 10 to 20 per cent., but that has nothing to do with you', and then hear what he will say to you, on such an argument. A large part of that additional profit, however, must be related to the differential of that man's ability. Just reverse the process, and say that you had the same manager as before, but double the capital, and you made a lot more profits, and the manager came to you and said, 'You have doubled your profits, and I want an increase from £1,000 to £2,000'. You would say 'That has nothing to do with you, because I have still only made 10 per cent. on my capital'. I think we must take the 'average profits' in this connexion in relation to these separate factors to get a common-sense result.

The one point I want to make is that there is a danger in taking all these different classes of business together and jumbling up a whole lot of elements which are not homogeneous. These factors and their rewards are, strictly speaking, many of them quite unrelated to capital, and from an economic point of view (I will not say from a 'commercial' point of view), it is absolutely false and irrelevant to relate them to capital, and they might as well be related to the cubic contents of the factory, or to the floor space. For income tax purposes it is perfectly true they are all liable, because they are all profits reaching the purses of some people, either coming to the hands of a single proprietor, or the different people who receive them. Also for the purposes of the excess profits duty it does quite well as long as you are comparing (*d*), (*e*), (*f*) with (*d*), (*e*), (*f*), or (*f*), (*g*), (*h*) with (*f*), (*g*), (*h*): you have a comparison of like with like. But the point is when you are substituting for that profits standard a percentage on capital standard, which of these elements (*a*), (*b*), (*c*), (*d*), (*e*), (*f*), (*g*), and (*h*) are you to select for your percentage standard in order to compare it with the various ingredients you may have in the particular case you are considering? It is certain you cannot have them all and we suggest that only those proper to capital can legally appear.

Now I would like to state, if I may, the statistical aspects of the word 'average'. Some such considerations have been raised this morning. It is just necessary to see what we aim at by 'average profits'. Commonly used, the word 'average' covers at least three distinct and opposed meanings. For instance, with reference to the average on capital, do we mean by that the aggregate amount of the profits as divided into the aggregate of the capital? If so, just think of the influence of a large case—one large case with considerable capital which goes up and down

violently, the others remaining fairly constant. That will shift the average very much up or down. Then we often mean by average, in the popular sense, the amount of profits most often found, that is to say, the common dividend. If you were to ask what is the average dividend of those companies, the ordinary man would not mean finding out the capital, and all these things, and working it out under the former conception. But if you took all the dividends and divided them by the number of companies, aggregated the dividends themselves without regard to the total capital, that is possibly what he might mean. We have had those conceptions rather confused this morning. What would be the influence of that one large case on the result? Far less in this instance than in the first.

Then there is a third meaning commonly used; you may say the average is the middle point; if a man says he has 'about the average', he may mean there are as many more as there are less, and he is in the middle of the range. The influence of a large case on that is nil; it does not shift the middle point at all.

These conceptions are present to every student of statistical science, and to show how dangerous are the fallacies attached to the different conceptions when you shift from the one to the other, I may say it has been necessary to give new names to them. In statistical science for the first conception the word is 'average'. We then go to the second conception, the thing most frequently found, the thing that has the greatest number of examples, and we employ the word 'mode' for that, and the middle point we describe as 'median', often a most useful thing. All statisticians are alive to the utmost importance of the distinction. What do we mean by average profits here? We mean the arithmetical point at which the aggregates, on division, will come. Now that may or may not be related to what we generally find existing. If I may be pardoned for giving an illustration which is found in text-books, I would like to illustrate by a cricketer's average. A cricketer with an average of 50 runs would, you say, be a man you might safely bet would, in the ordinary way, make in the neighbourhood of 50 runs. That might be a very wrong idea, and he might really be a man who would go in and either get out in the first over, after a run or two, because he had not got set, or make 100 if he did not get out in the first over. His scores are all very high or very low, and in that case you have a small mode and a large mode, and the average is a meaningless conception never actually found. I have been struck, in examining a large number of cases of profits, that the concerns making profits are very often divided into two groups or modes: those which are not shifting at all and those going up with a tremendous jump, and it might be dangerous to have that conception of average adopted. Thus we ought to be clear as to which we are choosing. Take an illustration of ordinary statistical 'distribution'. The proportion of cases where there are very low profits is small, and as you increase profits

the number comes up until about the central point of profits you have a larger number of cases, and then with the highest profits there are only one or two. In the normal distribution, the average, as we conceive it, is near the mode, and I will take as an example a hypothetical case disregarding differences in size. I have taken the case where we have 2 concerns making minus 6 per cent., 4 concerns making minus 4 per cent., 6 concerns making nothing, 10 making 4, 12 making 8, 20 making 32, 10 concerns making 100 and 4 making 300 per cent. You have them increasing from the small tail to the big centre, the 20 concerns with 32 per cent., and then sinking back again—68 concerns in all. The average of those concerns, using the word 'average' in the ordinary arithmetical sense, is 44 per cent. Suppose we increased them, during the war period that excess profits duty covers, in some arithmetical proportion. Suppose the smallest ones increased 2, and the next 4, the next 6, the next 8, the next 10, 12, 14, and 16; that is to say, the largest ones that made 300 now make 316, and the ones which made 32 now make 44, we find the new average to be 54.

(*Mr. Kerly*). What was the original one?

(*Mr. Stamp*). Forty-four; there is a difference of 10. If we were to take this conception, the average profits before the war, as the thing which was to be used in making the percentage standard, there would be, out of the 68 cases, 12 cases which rose from 8 per cent. to 18 per cent., wholly excluded from charge, and 20 cases earning, in what we should call the normal case, 32 per cent., rising to 44 per cent., which would also be excluded from charge. This is the reason, that a few large cases will set the arithmetical average high above the ordinary 'mode' or normal business of the class; so that it would be fallacious to take the 'average profits'. It might lead to the most grotesque results from the point of view of the application of the excess profits duty which would be charged. The few large cases would give us an average much higher than the general mode; the mode may rise enormously without reaching the old average. In those cases it rose by 12, and did not reach the old average, so that no charge could arise. If the high cases have not improved in themselves, there is no duty at all, and you could not have a more glaring example of businesses 'reaping where they have not sowed'; that is, than by taking 'average profits'. Take, for example, that the Act (and I think it is true too) intends to charge every man increasing his profits from 15 per cent. to 25 equally, then each such case should bear the same burden. The profits enjoyed, as the Chancellor said, distributed and enjoyed during the war, are 10 per cent. more than they used to be, and he is a fit subject for taxation. Ought there to be differentiation between different classes of people in different businesses, or the same businesses, rising from 15 to 25 per cent.? If you take 'average profits' there would be this danger and risk for some of the concerns engaged in trade before the war, that a man in industry *A* rises

from 15 to 25 and pays nothing, because he is protected by the 'average profits', which might be due to him as a percentage standard, whereas a man in industry *B* would not escape.

I am sorry if I have taken up the time of the Board too long, but I rather thought it was fundamental to clear up if possible the actual connotation of these two words, so as to see where in theory they get us to. I am now going to leave it to Mr. Clark to take up the legal aspect of how the Act applies to those particular interests, whether the Act enables us to take, in any of those senses, the profits, and, if so, in what sense, and whether it enables us to take the average profits as being equivalent to the percentage standard.

(*Mr. Clark*). From that point, having, as it were, defined profits, and dealt with the question of the average, I should like to proceed on the question of capital being the main thing—capital only; considering the difficulties and the dangers there are in dealing only with profits, I want to get back to the fundamental question that capital only is the thing for which you make an allowance in the Act. Mr. Stamp has pointed out that if you add energy to a business, you have nothing in the Act which enables you to give some additional allowance for that added energy. Suppose you take a new and vigorous partner into a business, he may be worth quite as much to you as putting £10,000 into it, but the Act makes no allowance whatever for that. There is no recognition or any reward for responsibility undertaken, or for credit facilities existing, the sole thing you recognize is capital. Take, for instance, the man who puts £10,000 into a business, and, in addition to that, works double the number of hours, what does the Act recognize as the proper addition to his standard? It recognizes a statutory or some other percentage varied by you to become the new statutory percentage in respect of the added capital, but it does not recognize any addition at all in respect of his added hours; and if you do not recognize the difference in the ability or the energy put into a business as between two different periods—and remember that under the Act you do recognize capital in the business as between two different periods—if you do not recognize brains or energy or work put into a business at two different periods as being a reason for making an allowance, my submission is that you should not do so as between two different traders. If a man at one time displays more energy or zeal or ability in his business, that is, during the present accounting period as compared with a previous time, you do not make any alteration in your standard; and my contention is, if you do not do it for a man at two different periods, you should not do it as between two different classes of trade. If you attempted to introduce such a factor as that into the percentage standard, you would get absolutely absurd results. There are businesses which make 100 per cent. on their capital. That 100 per cent. on the capital has, of course, to be divided, as Mr. Stamp has suggested, into a number of factors, but the fact remains that,

judged solely by the standard of capital, you have businesses which are making 100 per cent., and with added work might make 200 per cent. You are attempting a relation between two sets of circumstances, bringing in a factor which is not comparable with capital at all.

Now, sir, I should argue that while capital for its reward makes practically a similar demand in all trades, that is to say, that capital only makes the same demand in all trades, except there is some specific incident relating to the capital itself—that is the position we want to put before you—that although its requirement varies only within narrow limits, the requirements for personal factors differ very widely, and you have an instance before you here, in which it is alleged (and that to a large extent I do not dispute; it is for you to determine if it is so) that the large profits made in this particular trade are due to the fact that there is special skill and special ability put into that trade. Personally, I would suggest later that the real reason for the reward in this case is that there is a great deal of hard work put into the trade, and I have on my notes the very point the learned counsel, Mr. Kerly, one of your members, put forward, that in this trade as a whole, by comparison with a number of large trades, there is a greater element of personal supervision and personal care as compared with the capital invested.

I suggest, sir, that as soon as you get away from the original comparison between a man's own profits at two different periods, you enter a very much wider field, very much further away than the profits made in that particular business in which he is engaged. You go very much further afield, and you look at the conditions which attach to capital invested in all businesses. Now I am still harping on the question that we are looking at capital. We say, if you cannot compare a man's profits now with his profits before the war (and admittedly we cannot in some instances, because his profits before the war were so small, and you have admitted a new standard, the standard for the unsuccessful trader), then the standard should be not the profits made in that particular trade, but the profits which are the reward of capital, capital only, with the incidents which are specifically necessary for this particular trade. If you consider the three purposes for which you have to regard a change in your statutory rate as relating to this Act, I think you can see pretty clearly why it is necessary to look at it in that way. The statutory percentage is applied in these cases, in the case of an unsuccessful business, in the case of a new business, and in the case of further capital put into an old business. Now in the case of No. 1, that is, where you have a relatively unsuccessful business, what is being put before you now on behalf of this particular industry is that you should apply the standard of the successful man, or the average successful man, for the purpose of giving the unsuccessful man a standard. Now our suggestion is that that is entirely wrong, that you are not to take the standard of the successful man in this particular trade, because it is the standard of the successful

APPENDIX II

man; nor the standard of the average man that you are asked to apply to the whole of the trade. You are asked to say to the unsuccessful man 'you are to get the average reward in this business'. Now this business is by the very assumption of its circumstances a business requiring a very great deal of brains and education, and I think it is only fair to assume that where a fair standard of profit is not attained, it may be due to the absence of those very qualities which are alleged to be essential to the trade.

Now, if you assume a statutory earning capacity, you surely are not going to give the unsuccessful man a standard which he has himself proved he has not got.

(*Chairman*). That he has not come up to.

(*Mr. Clark*). That is so. He says: 'The standard of profits in my trade, the average profits from my trade, are large, and I submit I should have the average profits from my trade; that is to say, I am to have the profits of the successful people in this trade.' Why? 'Because this trade requires a lot of qualities and I have not got them. I ask you not to give me what is the perfectly reasonable reward for my capital invested in this trade, but to give me the reward of the average return common to these other qualities which are alleged to be constant in the trade.'

That is with regard to the first aspect of the capital, that is the aspect of the capital of the unsuccessful trader, to whom you are to give the statutory percentage. Now, with regard to the other two classes of capital, that is, either capital in a new business or added capital in an old business, those, of course, are exactly similar in their economic relations; you are dealing in each case with capital which is in a business now, and which before was not. Now, the question naturally arises, where was that capital before it was in the business it now is in? The answer is that it was presumably earning an investment rate of interest before it was introduced into this particular business. The ordinary commercial rate of interest is obviously the rate of interest laid down by the Act as 6 per cent. Invested in the business which is now under consideration, it is assumed to earn more than 6 per cent. during the accounting period (that is perfectly obvious or the case would not come before you). It must be earning more than 6 per cent. during the accounting period, or the question would not come forward at all. It seems absurd to argue that it should not be subjected to taxation, simply because other capital in the same hands or in other people's hands in the same class of business has earned a higher percentage. Our contention is that this is fresh capital looking for more than the usual reward of capital; and we say that the person introducing the capital is only entitled to the rewards of capital and not to the specific incidents of a business, unless those incidents are those which relate only to capital.

Now, sir, I would like you to consider the practical effect if you adopt such a suggested criterion as the previous earnings of a business.

Look at the practical effect! You would give a high rate to a successful trade, and a smaller rate to an unsuccessful trade. Now that is an absolutely absurd contradiction of the ordinary circumstances existing in business. A successful business can obtain capital at a lower, and not at a higher rate. If you have a really successful business, you can import fresh capital, and you can even borrow the capital, if you require it, at a lower rate. It is the unsuccessful business which has to pay the higher rate. You entirely reverse the true business proposition if you say that the average earnings are to be taken as an indication of the rate to be allowed in respect of the capital introduced. Throughout I am assuming that capital is only looking for the rewards of capital, and the more successful the business is, the less the rate, and not the greater the rate, which capital would require in order to be attracted to that business.

Now, sir, from that I go on to submit that any adjustments of the rate should be such as are necessarily incidental to the employment of the capital as such, that is, so as to obtain a dividend, the ordinary reward for introducing capital, and to provide for its ordinary security. If capital wastes you have to provide for its replacement; if the yield of capital is deferred you have to give a reward for that deferment. If the capital is subject to extraordinary fluctuations in the yield which it receives, receiving little in some cases and a large amount in others, then you obviously must make some provision for all those things that capital, as such, demands; but those I submit are the general class of things, and those only are the general class of things which should be borne in mind when dealing with the reward of capital as such.

I think we might look at the practical effect of a percentage if it is to be given in respect of the average earnings of a trade. At the present moment, or rather for the first accounting period, shipping pays a very small contribution to excess profits duty. Why? Because shipping has, in the period immediately antecedent to the war, had very high earnings. Now let us assume some other business, say milling, where the profit immediately antecedent to the war was small. Such a business as that pays a larger contribution if it now makes the same profits as shipping. Now, sir, if you can assume that the yield of shipping varies as between individuals from nothing up to 30 per cent., and that in the case of millers it has varied as from nothing up to 12 per cent., and if you then take the average, you would get (I am assuming the case on the arguments put forward) an allowance of 15 per cent. to the shipowner, and 6 per cent. to the millers. Now, you would have two most grotesque anomalies: The unsuccessful miller would get 6 per cent., and the unsuccessful shipowner would get 15 per cent., and the most successful miller would get a smaller rate than the least successful shipowner, for the most successful miller would only get 12 per cent., which is assumed to be the maximum earnings of the trade, and the least successful shipowner would get 15 per cent.

APPENDIX III

The first sketch of the principles underlying the ascertainment of the proper statutory percentage for a particular class

(Drawn by the officials who were to argue the cases for the Crown.)

The following considerations might be brought to the notice of the Referees in connexion with claims for a special statutory rate. If this be not done before the cases come before the Referees, some such general considerations and arguments must necessarily be placed before that Board at *each* of, at least, the first few cases that they consider.

It is obvious that the mere fact that certain selected traders in a trade are proved to have made profits in excess of 6-7 per cent. has no real bearing on the question; because even if the selected cases gave a true reflection of the whole trade (which is highly improbable) the total profits would include far more than the *commercial rate of interest*. They would in fact represent the earnings of commerce, including the rewards for exertion, skill and enterprise. (In some undertakings they might, and probably would, include the reward for facing personal danger and privations, e.g. a tea planter has to be paid something beyond the commercial rate of interest on the money he invests in his business, in order to afford him a sufficient inducement to live in a stifling climate, exiled from the civilization to which he is accustomed, and occupying his life in the supervision of native coolies.)

It is therefore necessary to eliminate from the total earnings of a business those rewards to the proprietor other than those which represent the commercial interest on his money, i.e. there can be no true comparison between total profits and a statutory percentage which is assumed to represent merely the commercial rate of interest.

This argument is emphasized by the fact that the pre-war standard is found in practice to be a profits standard in nearly every individual case, i.e. the total pecuniary reward of a proprietor of a business is in a vast majority (I should think 90 to 95 per cent.) of cases, much in excess of the percentage standard, and it seems *prima facie* evident that a special statutory rate is not contemplated for every such case.

Assuming these premises, i.e. that we cannot accept a comparison between average profits and the percentage standard and a substitution for the latter of a percentage equivalent to the former, we must attempt to find some other method of comparing the ordinary interest yield (assumed by the Act to be 6 per cent.) with the interest yield to which the special industries are equitably entitled.

Now the general position in regard to interest on money appears to be that:

Prior to the war 4 per cent. (or less) was the rate of interest that

could be earned on an investment where the following conditions existed:

- (a) The annual return was immediate, constant, and invariable.
- (b) The capital was absolutely secure (so far as human calculations could ascertain).

In other words, the two governing conditions are yield and security.

Now the only questions that affect yield appear to be those indicated above—its promptitude and its constancy and invariability; i.e. we have only to consider whether the yield is deferred or is irregular.

Similarly in regard to security we have to consider whether the capital may be lost because—

- (a) The asset is exhausted, or
- (b) The asset is destroyed or abandoned because it proves unproductive.

In regard to yield, it is to be observed that the rate of interest assumed in the Act is 6 per cent., being 2 per cent. more than the assumed normal earning of money under the conditions laid down above. Obviously this extra 2 per cent. must be intended to cover some or all of the contingencies already indicated in regard to yield and security. It cannot be intended to cover the first contingency, deferment of yield, because an allowance in respect of this contingency is specifically provided for by a special section of the Act (unremunerative capital). It is not contended by the Crown that it covers the question of the exhaustion of the asset by time, i.e. the Crown admits that where an asset is destroyed by use some special allowance should be given, and suggests that the method of ascertaining the amount of any such special allowance is by an actuarial calculation based on the life of the asset.

There remain to be considered the two questions of irregularity in the yield and the possibility of the destruction or abandonment of the asset. There is no intention to make any special provision in regard to the variation of yield, and that this is covered by the extra 2 per cent. If the yield were absolutely regular there would be no reason for giving more than 4 per cent.

The comparison of a 'class of trade' with the case of the individual trader supports the presumption that it is not intended to give a special statutory pre-war percentage standard on the ground of variation in yield. Where an individual trader has a varying profit he is allowed to select the best two out of three of his years if he takes a profits pre-war standard, but he is not allowed to take a varying rate of interest, i.e. if the business is a variable one, e.g. yielding a profit only in one or two years out of three. He cannot claim (having adopted a percentage standard) to assign the total percentage applicable to three years over one or two years, and this is because the 'commercial rate of interest' being greater than the normal rate of interest, already assumes a yield which is variable, i.e. the Act gives 6 per cent. not because that is the rate of

interest to be earned by money earning an interest at a constant rate, but because it is the commercial rate of interest which is assumed to be subject to variation.

There is no reason why a class of trade, i.e. a trade as a whole, should get better treatment than the individual trader does, and therefore it seems to me there is no case made out for an allowance of a percentage other than the normal 6 per cent. for a class of trade or business because its profits are variable.

This disposes of three out of the four reasons for an allowance of a percentage larger than 4 per cent. The remaining question is that of the destruction or abandonment of an asset, because it proves to be unprofitable. Now a good deal of this class of risk is covered by insurance, the premiums for which have been debited as working expenses, and any such loss so covered cannot be considered again for the purpose of allowing some percentage larger than the normal. In so far as losses in a trade are not generally covered by insurance, they would form the basis for a claim to a special statutory rate and there should be no great difficulty in proving the amount of such special liability to loss (not usually covered by insurance).

To sum up, the only variations from the normal statutory rate which ought to be made are:

- (1) In respect of unremunerative capital (an actuarial calculation specifically provided for under the Act).
- (2) The exhaustion of the asset because it is worn out (an actuarial calculation).
- (3) Allowances for special losses not covered by insurance common to the class of trade or business in respect of which the relief is claimed.

No doubt it will be argued that some regard should be had to the loss by the irregularity of the yield, but I think this should be resisted. Logically it was obviously wrong to allow a trader to take the best two out of three years profits as the standard. Such standard ought to have been the average profits of three or some longer number of years. This unfair selection of years must be regarded either as precluded when we are dealing with a percentage, or presumed to be included in the statutory percentage which exceeds by 2 per cent. the normal interest of money prior to the war; and is, indeed, the equivalent to taking a 6 per cent. earning for two years as the same as a steady 4 per cent. for three years.

The whole of this attempts to prove that the Act allows, or (we suggest) the Referees should allow, consideration of every condition affecting yield and security—*except fluctuation* in yield, which we maintain is already provided for in a statutory percentage 50 per cent. in excess of the percentage receivable prior to the war on a non-fluctuating investment *with all the other enumerated conditions allowed for.*

RESULT OF INVESTIGATION TO ASCERTAIN TRUE RATE OF INTEREST ON CAPITAL

(Free of risk, &c.)

Investors Monthly Journal, June 1914. Analysis and classification of *all* market quotations. (*Yield at market price*, to include redemption values)

Class of Stocks.	Number of Quotations.	Average of Yields.	Mode (point at which the highest number of quotations occur).	Median (the middle quotation of the class).
British or Indian Government Stocks	26	£ s. d. 3 10 4	£ s. d. 3 11 6	£ s. d. 3 11 0
Colonial Government Stocks	144	4 3 4	4 1 6	4 2 6
British Corporations and Counties	196	4 2 8	3 19 0	4 1 0
British Railways	348	4 7 4	4 2 6	4 4 6
Total	714			

Mode for all four classes .

. £4 1 6

APPENDIX IV EXCESS PROFITS DUTY AND MUNITIONS LEVY (£'000 omitted)

YEAR	NET RECEIPT			E.P.D. ASSESSED AND NO. OF ASSESSMENTS			MUNITIONS LEVY		EXCESS PROFITS DUTY AND MUNITIONS LEVY			
	E.P.D.	M. Levy	Total	No.	Gross Excess Profits	Duty £	No.	Levy Assessed	Set Offs	Discharges	Repayments and Interest Allowances	Total Deductions
1915-16	188	—	188	2,835	—	3,488	—	—	—	—	—	—
1916-17	136,826	4,789	141,615	56,430	—	146,720	2,717	49,730	9,913	4,933	1,182	16,028
1917-18	202,142	20,974	223,116	43,925	412,625	205,575	1,047	19,768	8,902	15,060	3,895	27,857
1918-19	261,611	22,386	283,977	62,432	512,594	397,711	1,047	19,768	11,128	27,410	7,573	46,111
1919-20	283,772	5,436	289,208	74,109	599,548	415,369	137	2,480	10,050	52,423	13,188	75,661
1920-21	217,145	954	218,099	75,409	773,541	369,509	59	694	9,528	54,392	18,026	81,946
1921-22	30,476	—807	29,670	45,056	371,432	215,581	14	76	7,229	81,290	92,672	181,191
1922-23	2,397	—1,275	1,123	15,593	87,800	50,374	15	30	2,445	72,193	55,028	129,666
G.B. and N.I. only.												
1923-24	382	—2,249	—1,867	5,689	24,838	14,628	7	21	624	41,868	25,396	67,886
1924-25	3,090	—332	2,758	4,670	22,497	13,281	5	22	585	30,279	11,183	42,047
1925-26	2,717	—334	2,382	4,654	21,100	12,012	9	11	402	20,868	8,384	29,664
1926-27	4,569	14	4,584	4,517	54,405	35,222	7	42	2,779	17,517	5,563	25,859
1927-28	—122	—173	—295	2,328	10,098	5,814	2	3	176	20,665	6,071	26,912
1928-29	1,705	—509	1,196	2,371	7,800	4,243	—	—	205	6,243	4,483	10,931
1929-30	1,757	—63	1,694	2,296	7,255	4,413	5	81	203	7,845	3,431	11,479
	1,148,657	48,791	1,197,448	401,804	—	1,973,990	4,024	72,958	64,169	452,986	256,085	773,240

GOVERNMENT INCOME—WORLD WAR PERIOD

31st March 1914 to 31st March 1923

In Millions Sterling

YEARS ENDED 31ST MARCH	1915	1916	1917	1918	1919	1920	TOTAL	AVERAGE
Exchequer Balance .	10	83	26	26	21	13	179	29·8
Tax Revenue								
Customs . . .	39	60	71	71	103	149	493	81·8
Excise . . .	42	61	56	39	60	133	391	65·1
Estate Duties . .	28	31	31	32	30	41	193	32·2
Stamps . . .	8	7	8	8	12	23	66	11·0
Land, house, &c. .	3	3	3	3	3	4	19	3·2
Property and In- come including super tax . . .	69	128	205	240	291	359	1,292	215·3
Excess Profits .	—	*	140	220	285	290	935	156·0
Total tax . . .	189	290	514	613	784	999	3,389	564·8
Post Office . . .	29	34	34	35	40	44	216	36·0
†Sundry . . .	8	13	25	59	65	296	466	77·7
Total Revenue .	226	337	573	707	889	1,339	4,071	678·5
Borrowing, Net .	410	1,167	1,629	1,985	1,682	323	7,196	1199·3
Total net receipts	636	1,504	2,202	2,692	2,571	1,662	11,267	1877·8
Total resources .	646	1,587	2,228	2,718	2,592	1,675	11,446	1907·7
Revenue—% receipts	35·53	22·40	26·02	26·26	34·58	80·56	36·2	36·2
Borrowing—% „ .	64·47	77·59	73·98	73·74	65·42	19·44	63·8	63·8

* £140,000.

† Including war contributions from India, and other overseas colonies and dependencies; also receipts from sales of war property and from trading undertakings, &c.

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